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Macro Research

Weekly update 42/2019

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Last week – the main takes

- **A skinny trade truce, though better than none:** Trump was satisfied, the 13th trade talk round concluded that China will buy some more soy beans and pork, and US will not escalate tariffs as planned from Oct 15. Talks will continue. At least better than the alternative, but the trade war is still hot – and we doubt companies world wide will feel uncertainty is gone. Stock markets fell when the 'deal' was announced. **Finally, some positive Brexit news;** the pound and UK interest rates soared after news on a possible Brexit compromise; UK accepts that North Ireland remains within the EU common market, and the rest of May's divorces deal is accepted, UK payment included – and a hard Brexit is avoided (as Johnson surrendered?) The EU council will meet this week
- **Chinese exports** have been trending up since last Dec, and is close to record high in volume terms (you will not read this in today's fake media!). Imports have flattened recent months. Imports are 10% below the 2018 peak but just some few per cent below a reasonable trend line (which will not be reported like that either)
- **US Core CPI inflation** held steady at 2.4% in Sept, the highest in 11 years. Underlying growth has accelerated to 3%, however, producer price inflation, which is decelerating, and inflation models do not signal much higher consumer price growth now. **UoM's consumer sentiment index** rebounded in October, more than half the Aug slip is now reversed. **Fed meeting minutes** showed that the FOMC was split as to whether the Sept cut was the appropriate action, which we already knew, no substantial market reactions. At Tuesday, Powell announced that Fed will start **buying short dated treasury bills** in order to increase liquidity in the money market, and at Friday Fed surprised markets when communicating the size of the program, USD 60 bn/month until 2Q next year. (This is 'normal' monetary policy to manage the short term interest rate, not QE to lower long term rates. **Job openings** are sliding down from the top, probably an early sign of a softening labour market. Yet, **jobless claims** remain close to record low. **Small business optimism** fell in Sept, but remains much stronger than the major business surveys. However, the SMEs are reporting lower price plans, hiring plans and cap ex plans; obvious signs of retreating demand
- **Eurozone industrial production** probably inched up some 0.2% m/m in August, lifted by Germany and Spain. Still, production is trending straight down, and German manufacturing orders do not signal any recovery. **German exports** fell in Aug, and remains closely correlated to the global trade cycle. Manufacturing production is as usual even weaker, domestic demand is slowing too
- **The Norwegian 2020 National budget** was slightly contractionary with low growth in Government spending, which is appropriate, given the upswing in the Norwegian economy. The budget impulse was -0.2% (although 'really' just -0.1%, adjusted for a temporarily hike in climate quota sales), 0.2 – 0.3 pp tighter than expected. **Core CPI inflation** accelerated marginally to 2.2% in Sept, 0.1 pp above f'casts. **Manufacturing production** slowed in Aug after soaring the prior month. Oil related production is probably at/close to the growth peak, other sectors remain lackluster

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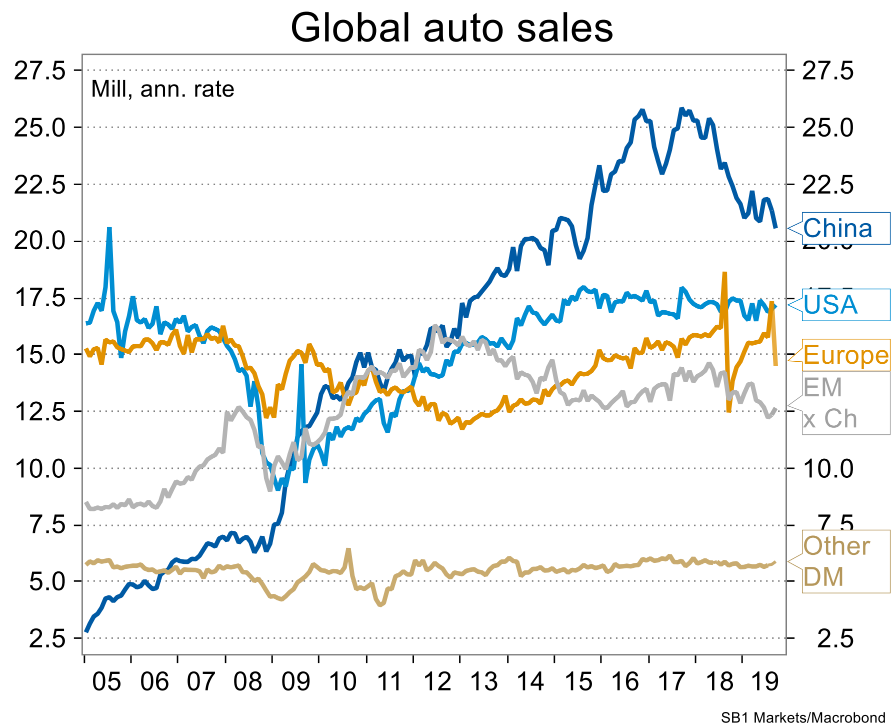
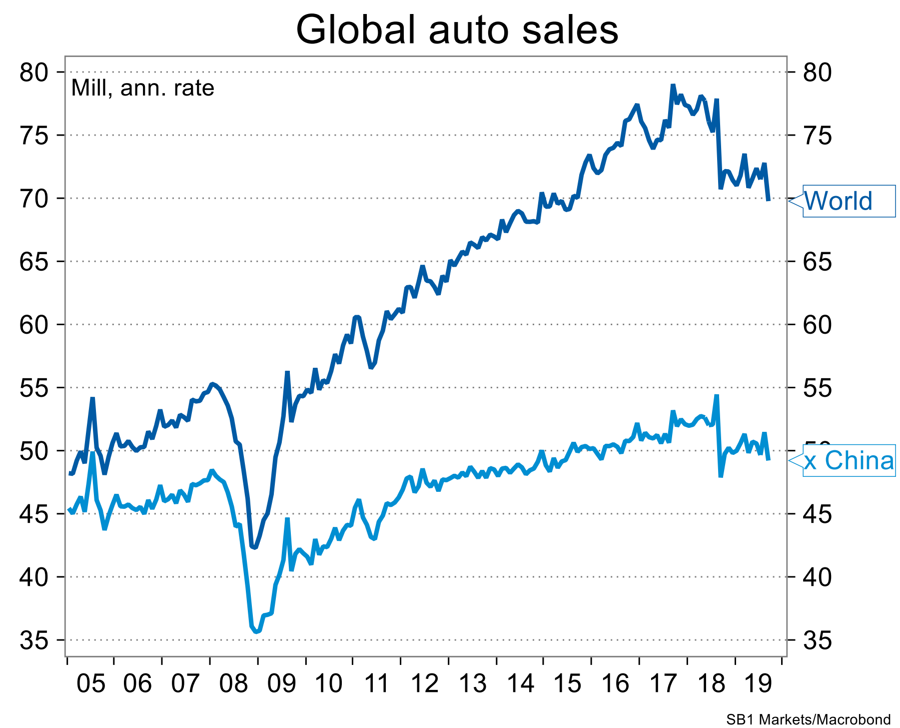
Auto sales sharply down in Sept, mostly 'technical' but China still sagging

European sales down 16% m/m from the Aug spike, adjustment to tighter emission rules

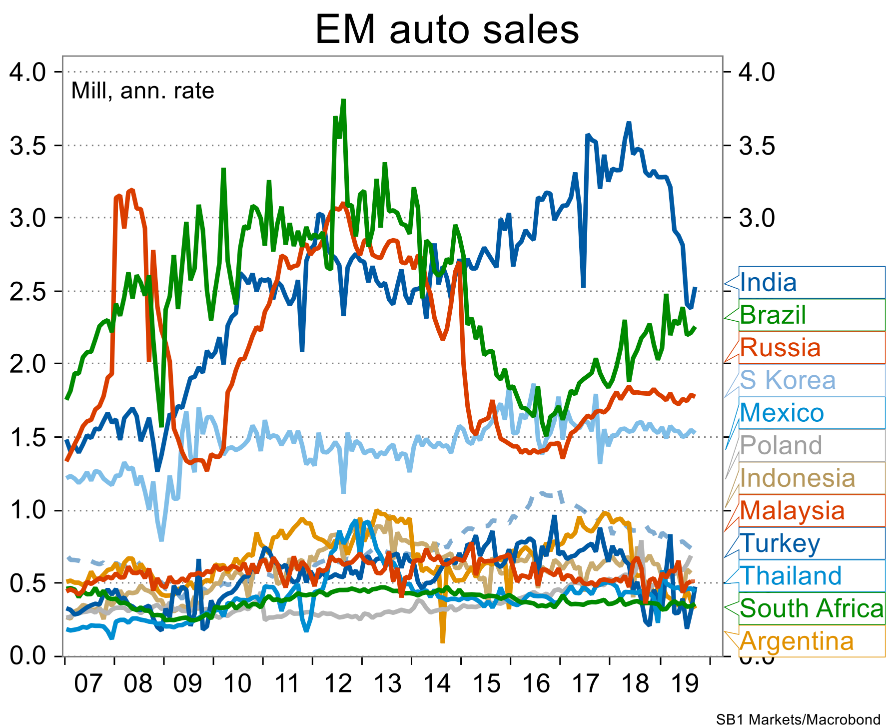


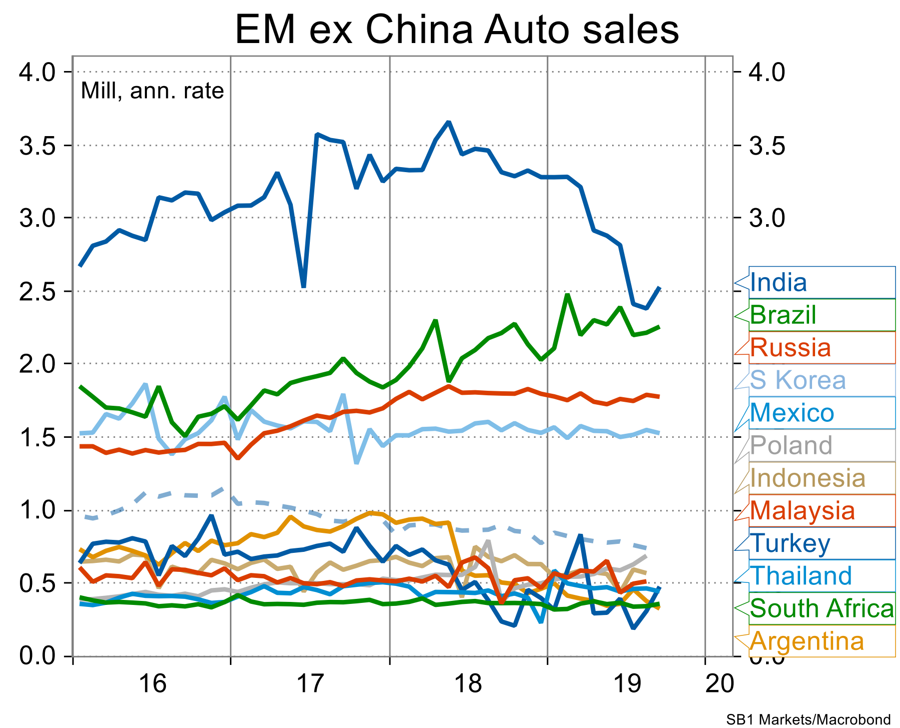


- Global sales fell 4% m/m in Sept (from +2% lift in Aug), but are down just 1.3% y/y – as sales 'collapsed' in Sept '18 – and have remained low ever since, and sales are down some 8% from the level last summer (at the lowest level since 2015). Data are preliminary, also Chinese sales
- Sales in Europe fell sharply from a high level in Aug when inventories for cars complying with old emission standards had to be cleared, with substantial rebates. Sales in Sept were most likely far below 'normal'. Before the Aug spike, sales had recovered from last years emission standard downturn. US sales rose, as did sales in other DM
- Chinese sales fell further 4% m/m in Sept, and are still trending down – and are down almost 20% from the peak last year.
- Auto sales in EM ex. China rose marginally in Sept but the level is low, following a long journey downwards, -23% from the peak 7 y ago, -14% from early 2018! Indian sales rose m/m but are down 30% from the '18 peak

EM x China up in Sept but is trending down, strength nowhere

Indian sales may have stabilised, at a low level. Brazil, Russia flat, at mediocre levels

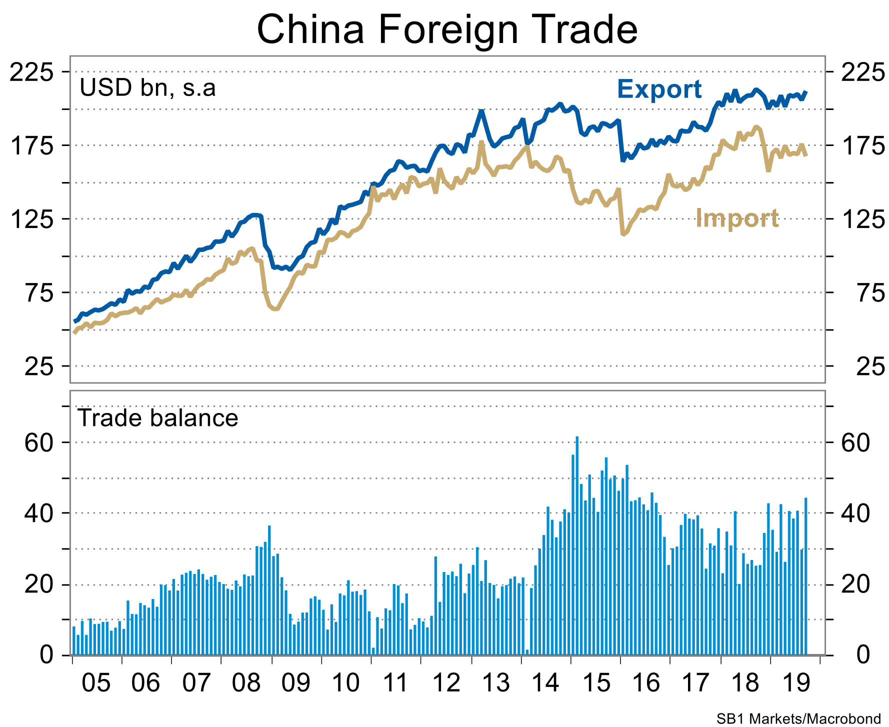




- Indian sales rose m/m i Sept but the levels is way below the 2018 peak (close to -30%)
- Brazilian sales have flattened and Russia is still below the (low) local 2018 peak. Sales are sluggish in South Korea & even more in Mexico. Poland the only bright spot
- Turkish sales have been extra volatile recently and were ‘record’ low in July but has recovered somewhat in Aug/Sept. Argentina has fallen to 12th (and bottom) of our EM universe, from a 5th place in the ranking in 2017/early 2019 (down 60%)

Exports are trending up, imports are flat, none are signalling any crisis

Exports are down 3% y/y but have trended up since last Dec, both in value/volume

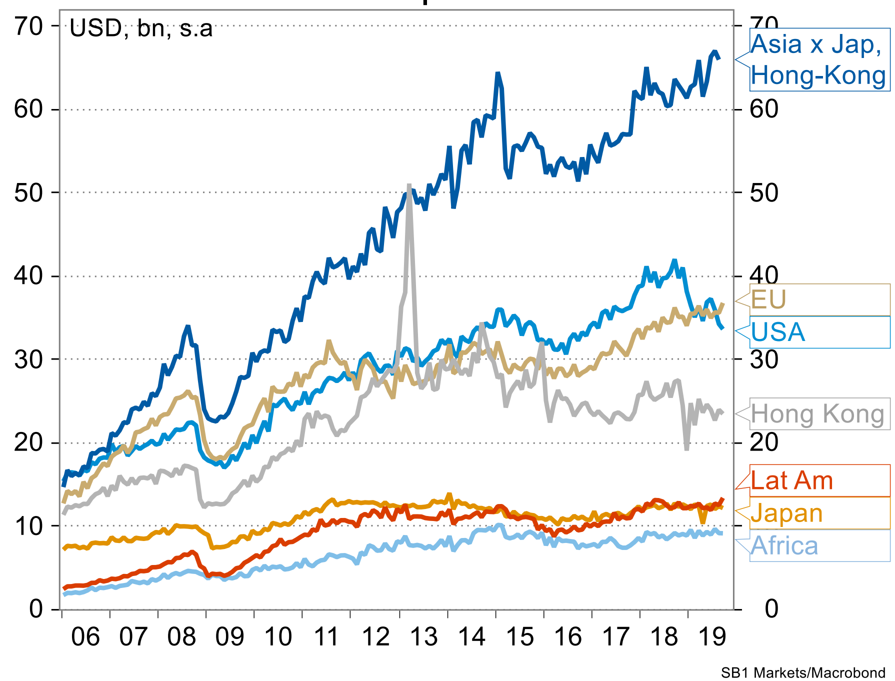


- Exports were reported down 3.2% y/y in USD in Sept, as expected, down from -1% in Aug. Still, exports rose 3% m/m and have been slowly been trending up since the local bottom last Dec. If exports keep up at the current level in spite of the escalating trade war (the skinny trade truce agreed upon at Friday just prevent the announced extra tariffs from Oct 15), China will soon report growth y/y. Export volumes are trending up too, and the volume was probably close to all time high in September!
  - » Exports to the US fell further in Sept and are down USD 8 bn, or 20% since 2018 (equalling 4% of total exports). Exports to other regions have compensated most of the decline in export to US, especially to the rest of Asia. Still, growth has slowed in most directions
- Imports were down 8.5% y/y in Sept, expected -6%. Imports fell by 5% m/m (following +4% m/m in Aug). The trend is slowly up since Dec '18, but it is quite flat recent months. In volume terms, imports are down 10% from the peak last year, a substantial decline but not that unusual – and import volumes are not far below a reasonable long term trend line, and <u>does not signal a sharp weakening of domestic demand</u>
- The trade balance was stronger than expected, at USD 40 bn (44 bn, seasonally adj, highest since 2016!)

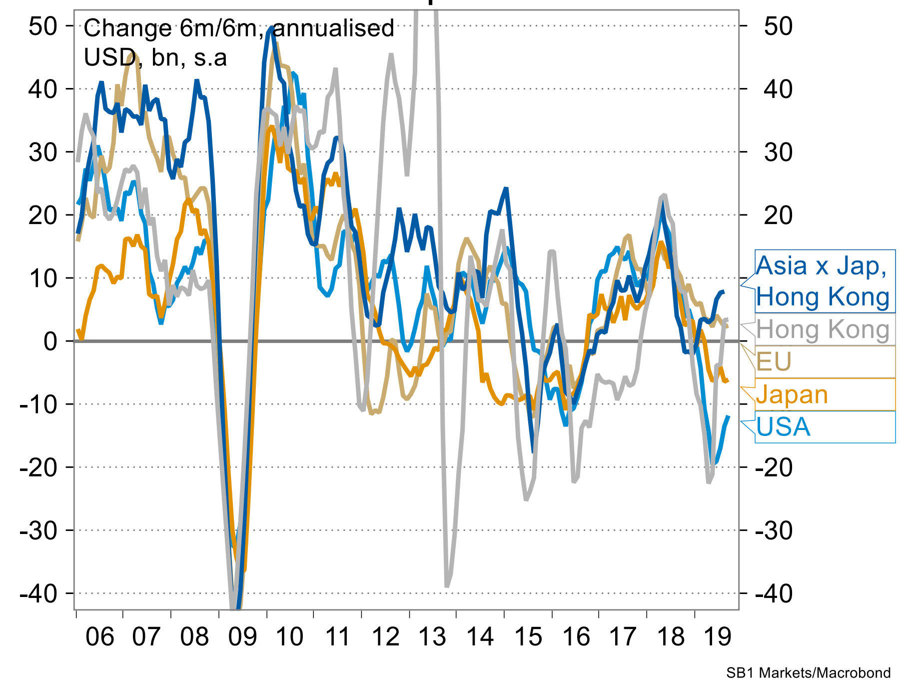
Exports to the US down 30%, but there is a ROW

Exports to H-K down too, but exports to most of the rest of the world are still on the way up

China Export markets



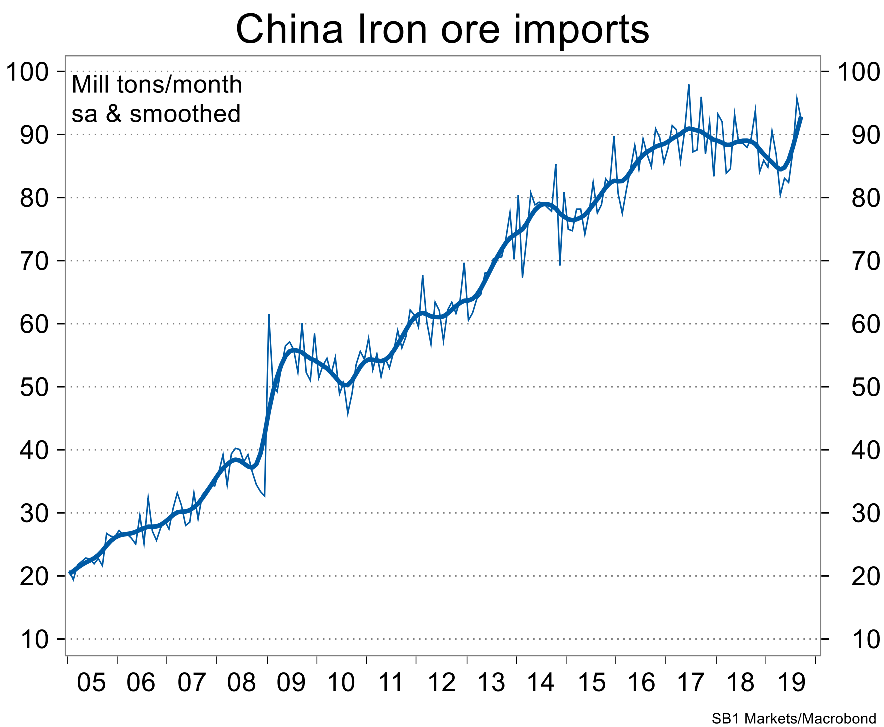
China Export markets

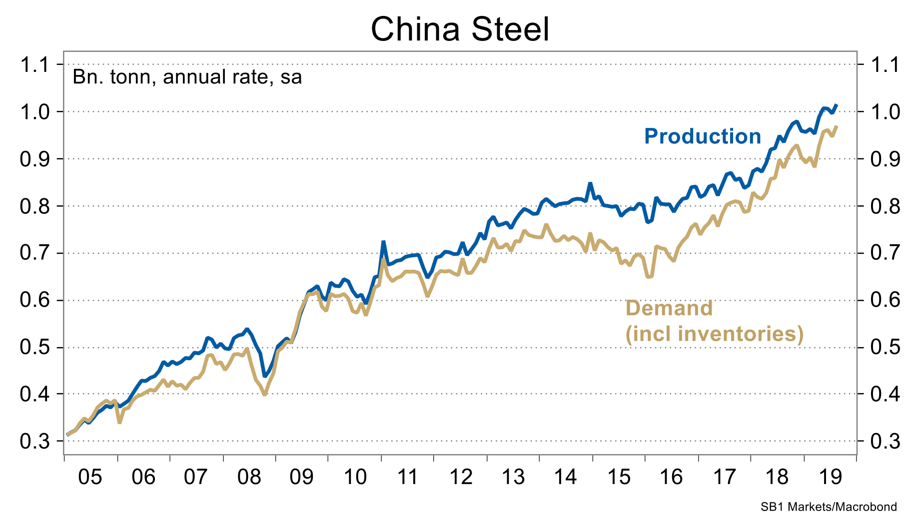


- Exports to the US are hurt by the tariffs, now down some 30% from the peak in early 2018, equalling 4% of all Chinese exports. Tariffs were lifted substantially from Sept 1 and more tariffs will be implemented in Dec (but the announced increases from Oct 15 is now put on hold, following the trade deal last Friday. A further decline in exports to the US must be expected
  - Exports to the US equalled 18% of total Chinese goods exports (and exports to EU 16%, rest of Asia 48%, all before US tariffs)
  - Total exports equal some 20% of GDP, exports to the US 3.6% of GDP – now down 30% from the peak, shaving a gross 1% from GDP (however, dampened by lower need for imports as inputs for these exports, and the impact of redirections of exports). The total trade surplus in volume terms is up, as imports have fallen – and net trade is now supporting Chinese growth
  - The real economic risk for China & elsewhere: Trade uncertainty is hurting investments as companies may postpone investment decisions until the dust settles – and both Chinese and foreign company are reallocating from China to other countries. Some households may become worried too

Iron ore imports back to all time high in Aug/Sept

Net steel exports is trending down, domestic demand even more up than production

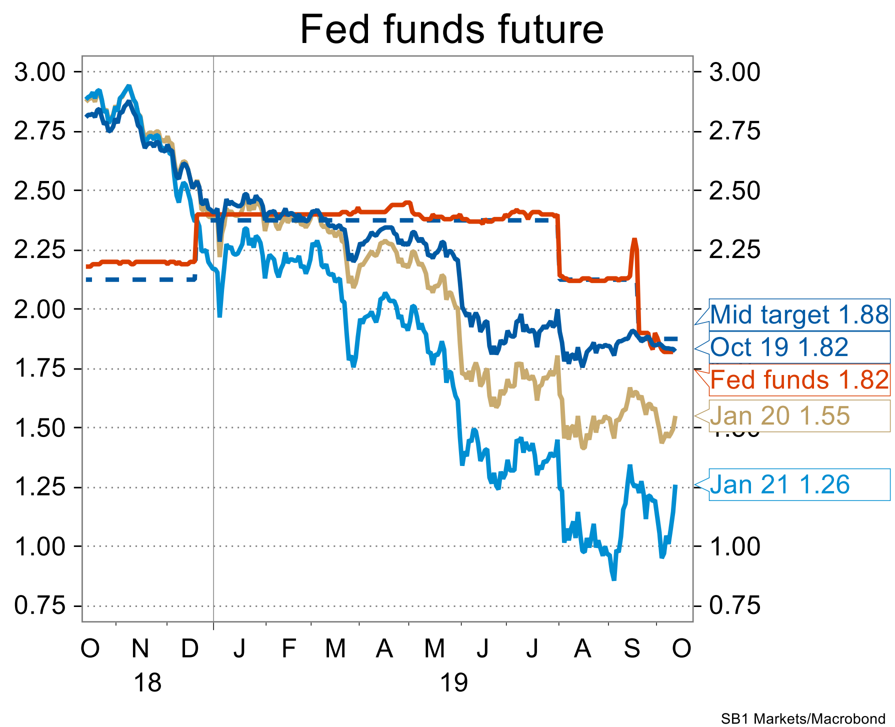


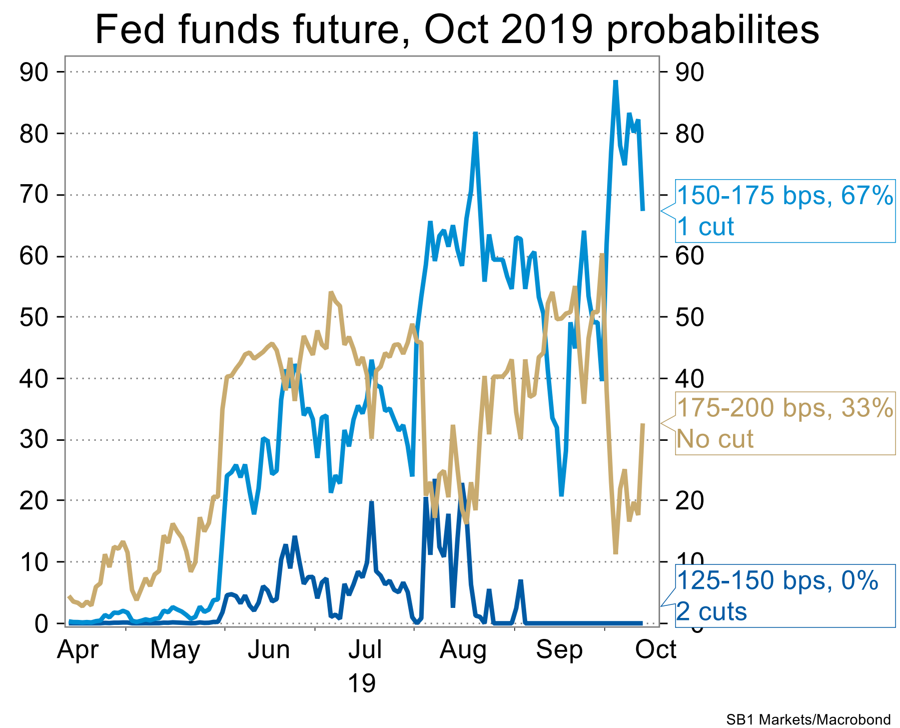


- Iron ore imports have been dragged down due to production problems in Brazil. Following a 10%+ surge recent past 3 months, imports are back at a record high level – which is needed, given a record high level of crude steel production (and record high domestic demand)
- Net steel exports equals some 6% of Rest of World production, probably too high. However, 3 years ago it equalled 13%!!

No major news from the Fed meeting minutes, the FOMC is divided

The cut was based on a 'risk management' assessment, as macro data had not deteriorated

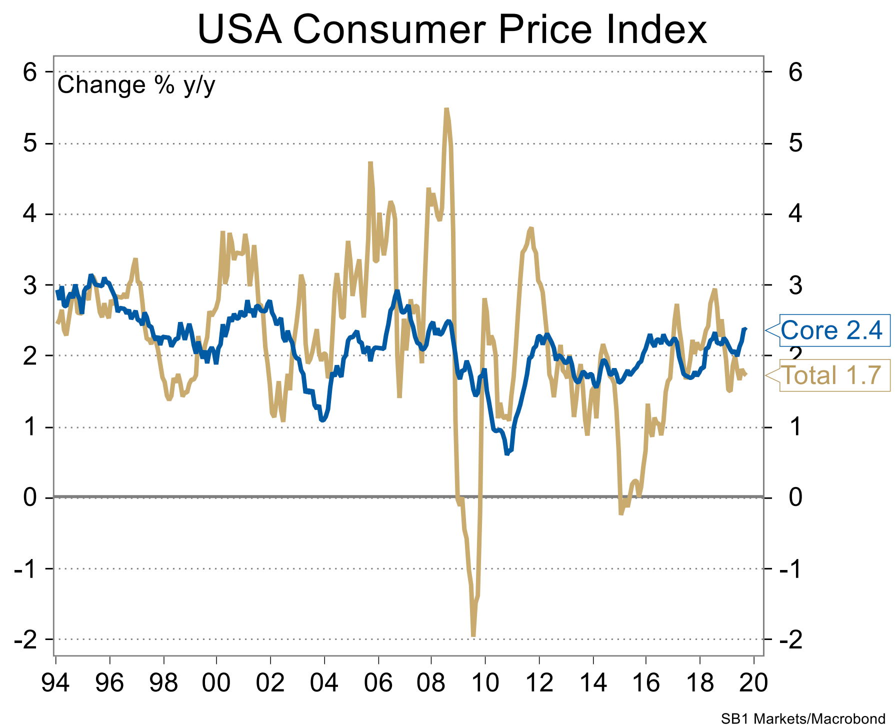


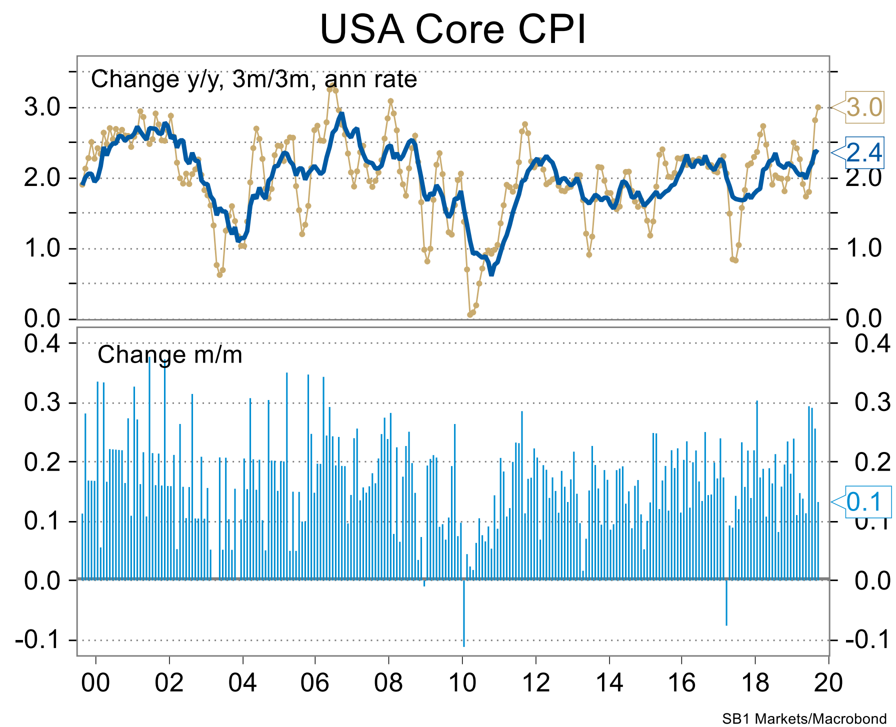


- Minutes from Sept 18 meeting once again underlined the lack of consensus at the FOMC. 7 members voted in favour of a 25 bps cut, while 2 members voted for an unchanged interest rate, and one member preferred a 50 bps cut
  - Most members argued that downside risks to the growth outlook had become more pronounced since then July meeting, primarily due to the persistent trade dispute, and larger than the risk for inflation overshooting at the upside. The two who disagreed with the cut emphasized that economic data in general did not justify an interest rate cut (we can't say we disagree with this!), . Some also noted that market pricing indicated a more accommodative policy than they found to be appropriate
  - In a speech on Tuesday, Powell announced that the Fed will soon start to buy short dates Treasuries bill in response to the recent funding issues in the money market. Powell emphasized that this is not equal to a reintroduction of QE (which was designed to lower long term interest rates). At Friday, Fed announced a USD 60 bn/month purchase Treasury bill program, more than expected
- The minutes did not reveal much new information from the June meeting. Market reactions were muted, market rates edged up Wednesday, we assume on trade deal optimism. A cut on Oct 30 is now expected by some 70% probability (it came down Friday)

Core inflation unch at 2.4%, the highest in 11 years

Core CPI up just 0.1% m/m in Sept, but underlying growth at 3.0%

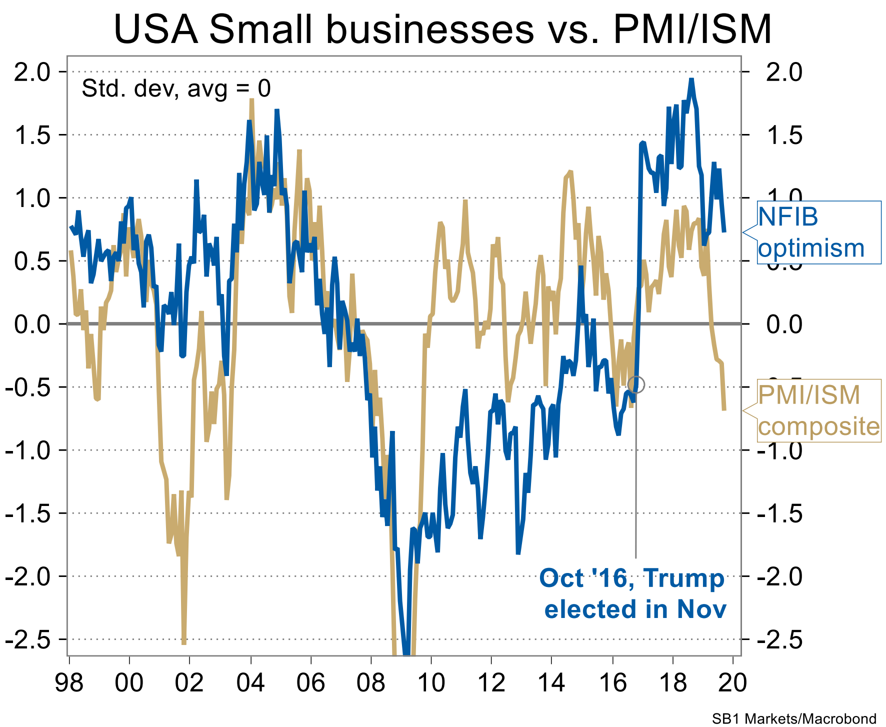


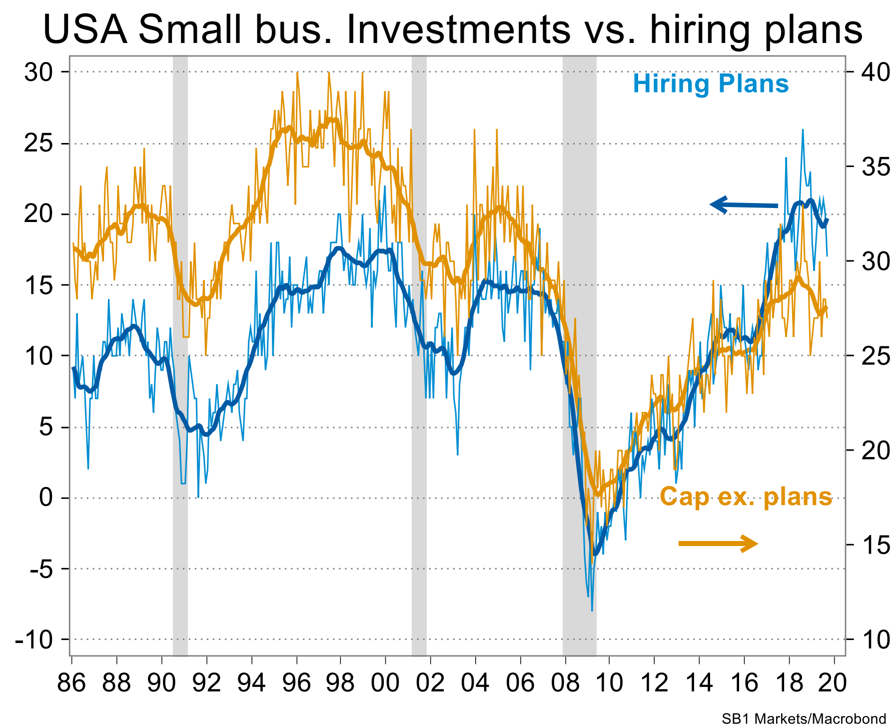


- Core CPI increased by just 0.13% m/m in September, after growing strongly the 3 prior months. The annual rate held steady at 2.4%, the highest since 2008. Underlying growth accelerated to 3.0%, may be signalling a lift in the annual rale. However, we doubt that inflation will increase much from this pace, as producer price and inflation models indicate that inflation may be peaking now. But it is not 'too' low, at least according to the CPI index
  - » Fed preferred price measure, the core PCE (the consumption deflator) is up 1.8%, below Fed's 2% price target
- Headline inflation fell marginally to 1.7%. Inflation has stabilised after being pulled down by declining energy prices

Small businesses' optimism cools, still miles above PMI/ISM (activity)

NFIB optimism index is not weak – but cap ex, hiring, wage and price plans are lowered

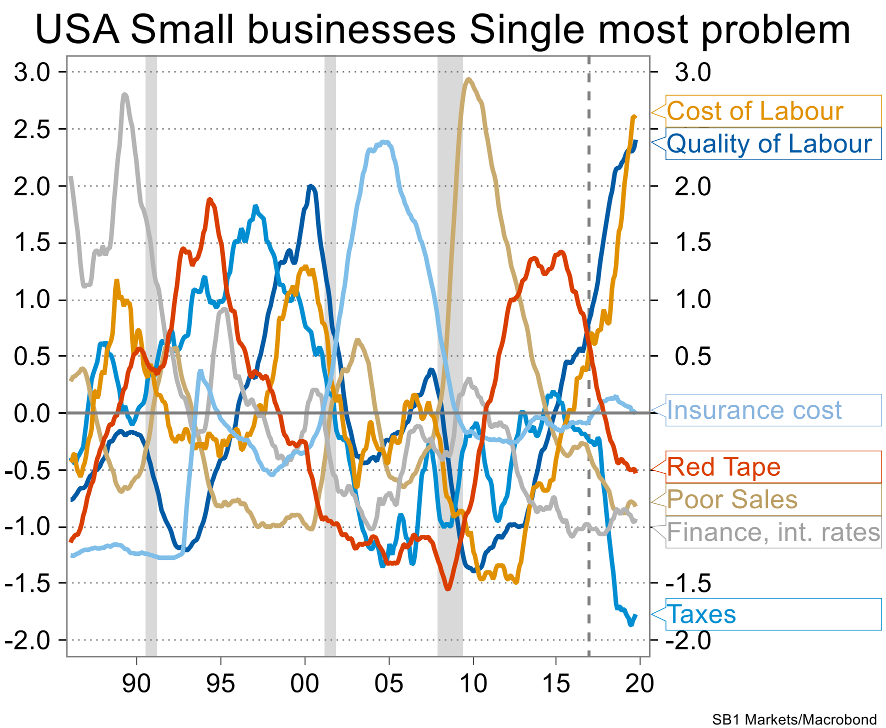


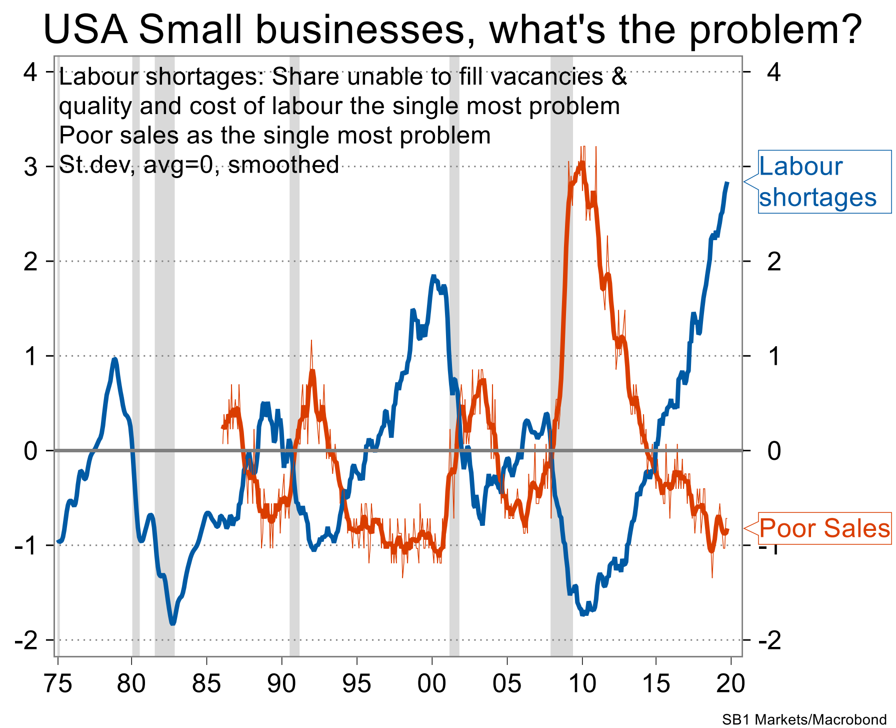


- The NFIB optimism index, measuring small businesses' expectations on business conditions, fell to 101.8 in September, slightly weaker than expected. Yet, the index has stabilised this year, still at a rather high level, after dropping in late 2018
  - » The NFIB optimism index is 0.7 st.dev above average. The surveys from ISM/Markit PMI (and most others) reports are well below average, signalling declining production below average levels. These different measures are not very closely correlated. The difference now may be due to the SME's exposure to the domestic market, while larger companies in the ISM/PMI are more influence by trade war uncertainties (export orders are plunging)
- Investment plans are slowly heading south, from a rather low level, compared to previous peaks
- Hiring plans har probably peaked but they are still aggressive. Companies are still not able to fill vacant positions

What's the problem? Cost & quality of labour, not sales, interest rates or taxes

US SMEs have never before reported more problems due to cost and quality of labour!

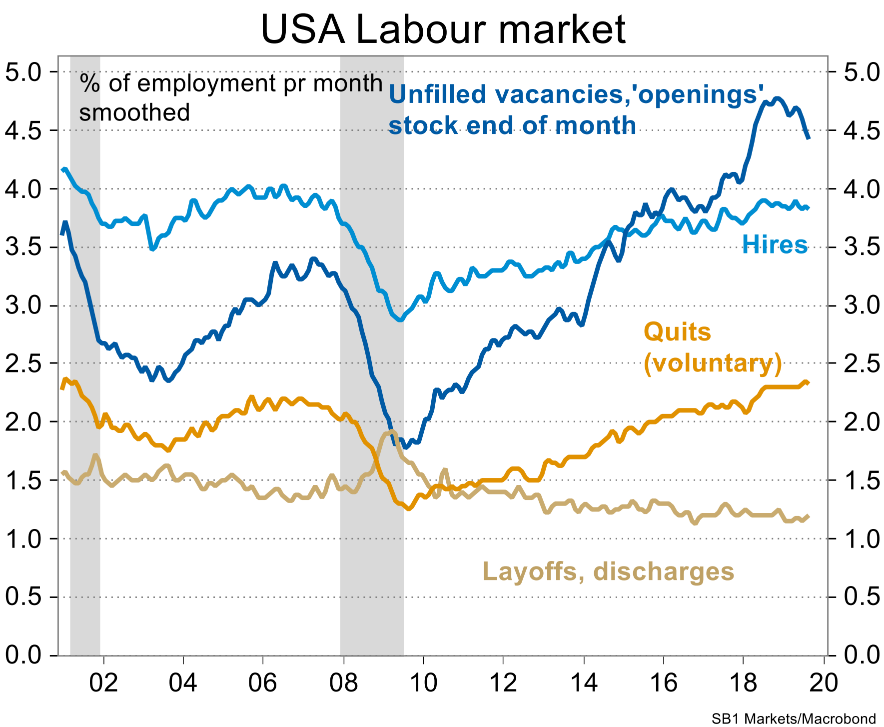


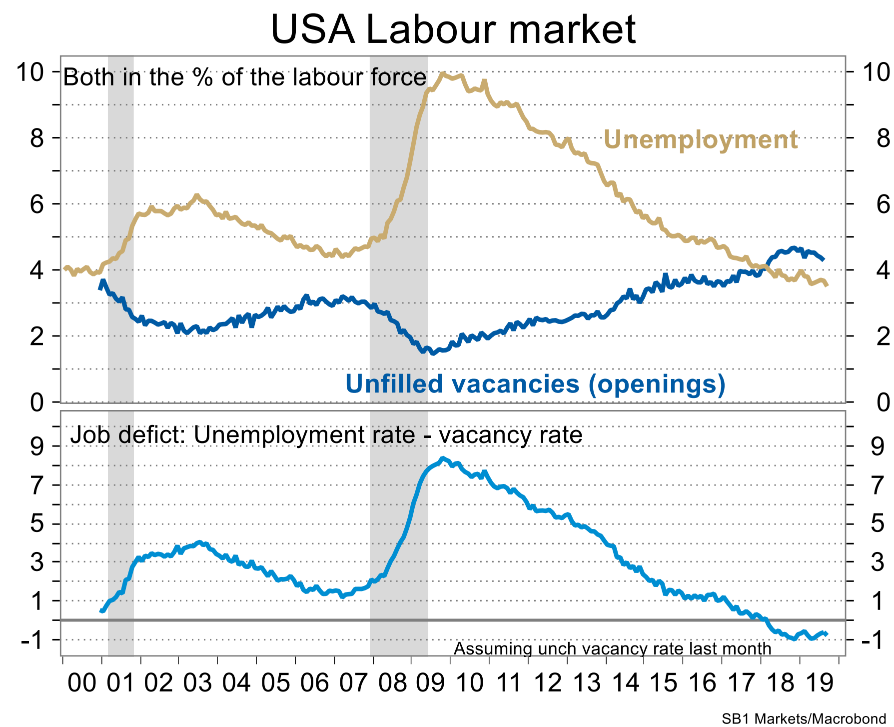


- And fewer than ever are complaining about finance/interest rates and about taxes, following last year's tax cuts
- Sales are not the problem either, almost 20 year since so few stated sales as the most important problem
- So the answer is obvious: The Fed must cut the fed fund to zero, or below, the USD must be taken down, as must taxes!
  - » Sure, at one stage in the economic cycle substantial interest rate cuts will be appropriate. It's just not now?

Unfilled vacancies down from peak, an early sign of a cooling labour market?

Still, a record number of people are leaving their job voluntary (to get a better) and layoffs are low

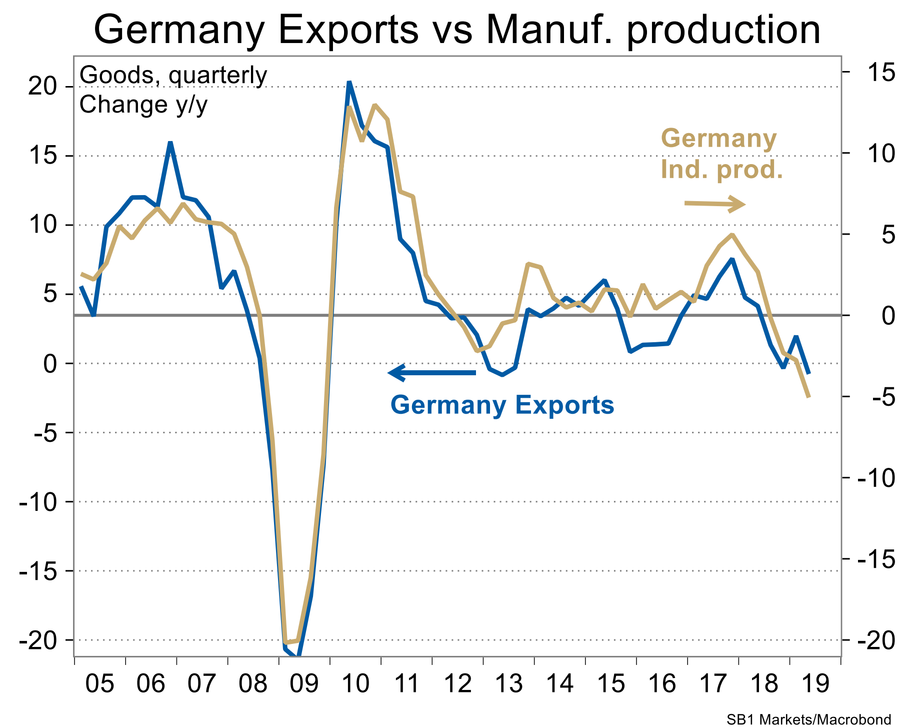




- The August JOLTS report suggests that the labour market may be starting to slowly cool off as the economy slows, job openings (unfilled vacancies) ticked down for the third straight month. The level remains elevated and the labour market is no doubt tight; there are still more unfilled jobs (4.3%) than unemployed people (3.5%). The gap is close to record high. Monthly (gross) hiring equals 3.8% (of total employment) and is not increasing anymore, most likely as businesses struggle to attract labour
- The number of voluntary quits is rising marginally, at a very high level – as many employees leave for better (paid) jobs
- Layoffs are trending down and is at very low level – but that's a lagging indicator

Guess what, German foreign trade is closely correlated to…

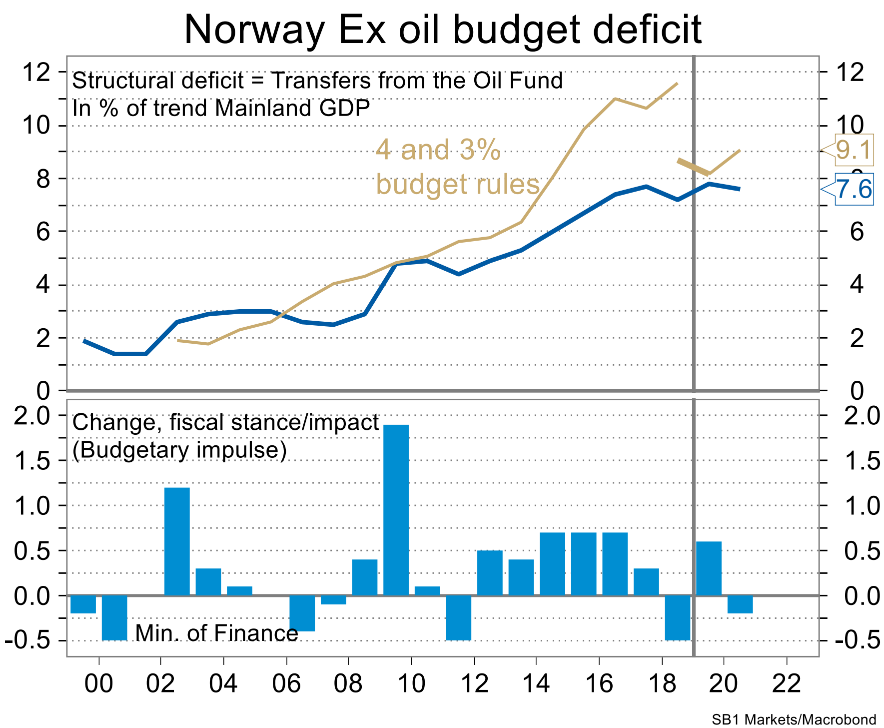
.. global trade. Now, both have stagnated due to trade war/Brexit uncertainties, and a mature cycle



- Both German foreign trade (and thus lobal trade) is highly correlated to German industrial production, though with production growing at a slower pace. In addition, production is a tad more volatile than exports.
  - » In sum, the current decline in production is not that far below 'normal', given the modest decline in exports.
- The reason is that domestic demand weakens in line with global demand (or some inventories are emptied or imports have taken a larger market share). Given signals from PMIs/other surveys, a near term production recovery is not likely

A tighter 2020 budget than expected (and not just on the paper)

A budget impulse at -0.2%, and expenditure growth was lower than we expected



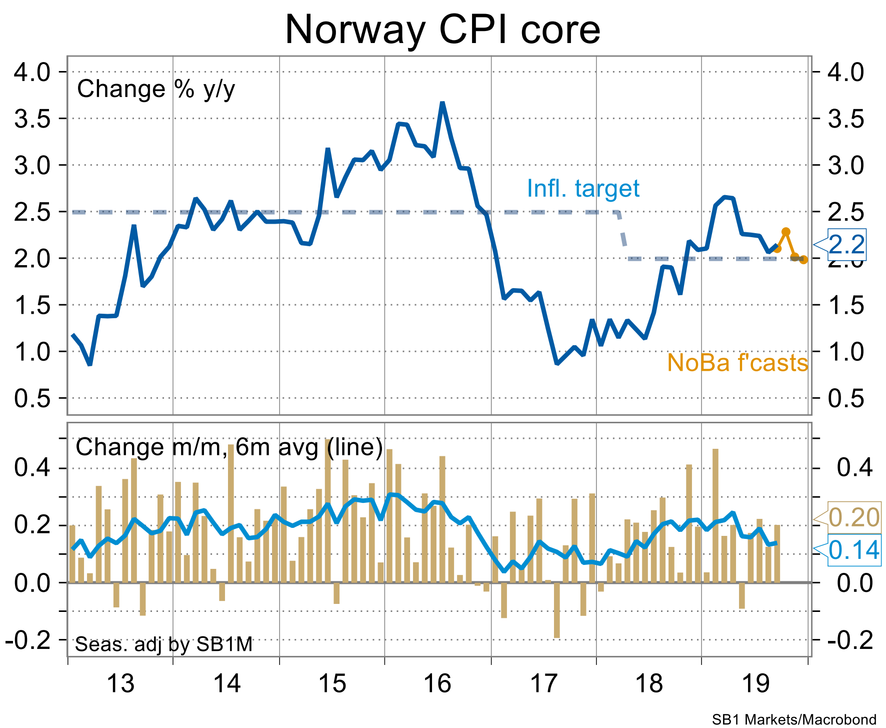
Fiscal indicators NOK bn, per cent	2018	2019	2020	SB1 est 2020
Actual surplus, incl. oil	250	234	246	189
Surplus ex. oil	-219	-233	-241	-237
Structural surplus ex oil	**-214**	**-239**	**-244**	**-249**
.... change in bn	0	-25	-5	-14
.. in % of GDP	-7.2	-7.8	-7.6	-7.8
... Change (fiscal indicator)	**-0.1**	**-0.6**	**0.2**	**-0.2**
.. in % of Oil Fund value	2.5	2.7	2.6	2.6
Spending rule, bn.	-255	-261	-285	-292
Deviation from rule, bn.	41	22	41	43
Real growth in underlying spending	1.7	2.0	0.8	1.8
Petroleum Fund, bn, ult.	8243	9500	9985	10183

Min of Finance, Sparebank1 Markets

- The government certainly 'passed the test', following an expansionary 2019 budget. The 2020 structural nonoil deficit was raised to NOK 244 bn, slightly less than we expected. Hence, the fiscal indicator equals -0.2%, from +0.6% in 2019.
  - » 0.1 pp of the tightening is due to transitory revenues from sales of climate quotas (which will weaken the budget next year by almost 0.3 pp). We expected a +0.2% impulse net of these quotas, so the budget was 0.3 pp tighter than we expected. In the table above, the indicator is measured as change in the surplus, not deficit
  - » Underlying growth in expenditure is estimated to 0.8%, we expected +1.8%.
- The 2020 nonoil deficit (=transfers from the Fund) equals 2.6% of the Fund's value, well below the spending rule at 3% (by NOK 41 bn). Nobody reckons 3% to be appropriate now, given growth in the Fund value and the upswing in the Norwegian economy

Core inflation edged up to 2.2% in Sept, total inflation eased to 1.5%

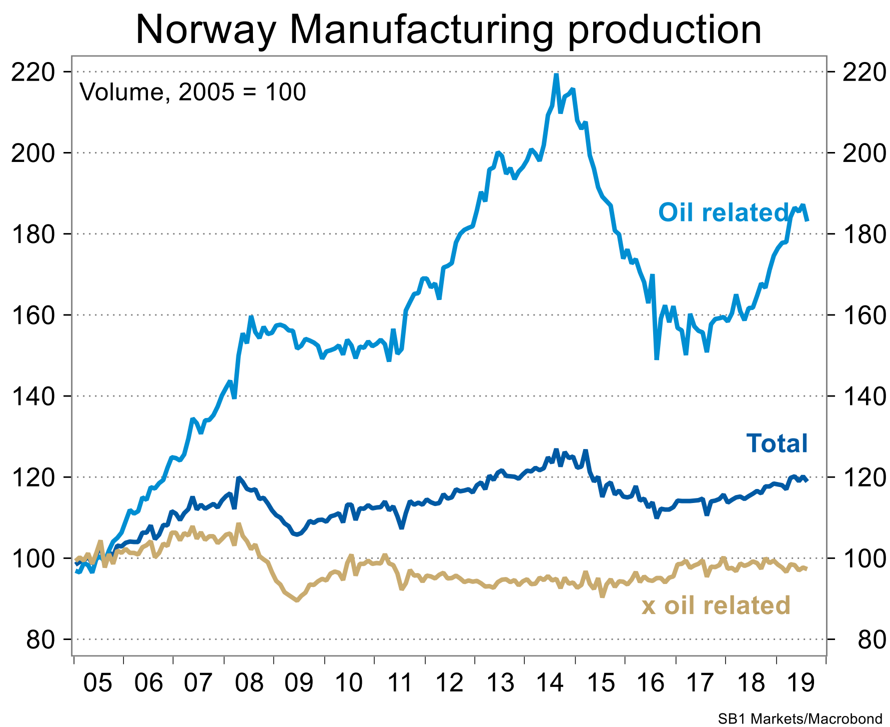
Core CPI inflation has been cooling since the spring but remains above the price target

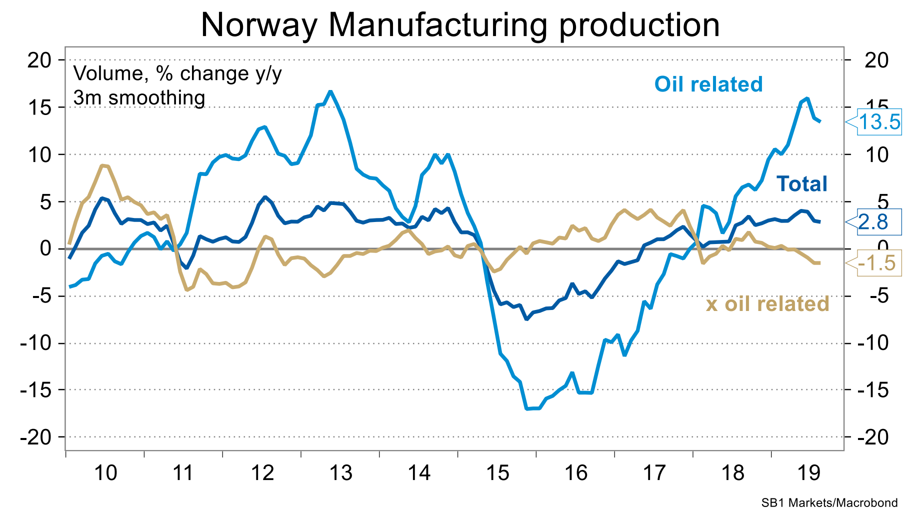


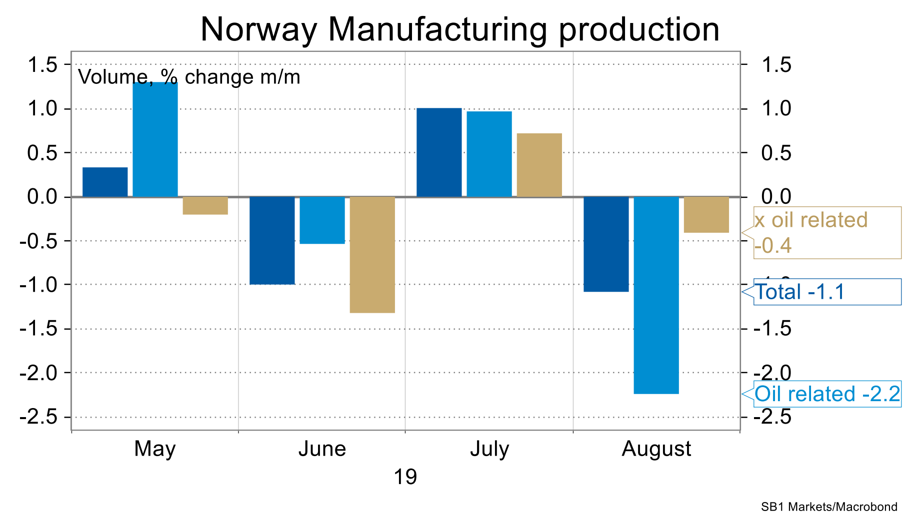
- CPI-ATE (ex. energy and taxes) rose 0.1 pp to 2.2% y/y in Sept, we and consensus expected an unchanged pace of inflation. In the Sept MPR, Norges Bank's nudged down the inflation f'cast to a 2.1% speed in Sept (and 2.3% for 2019)
  - » CPI-ATE rose 0.2% m/m (seas adj), slightly above the 6 m average
  - » Accelerating prices on airline tickets and furniture & household equipment boosted monthly inflation. Core y/y inflation excl. the volatile airline tickets equals 1.9%
  - » Imported goods are up just 1.2% y/y, and we do not expect much more, even with the weak NOK. Domestic goods & serv. up 2.6%, due to wage inflation above 3%, slow productivity growth and capacity to increase prices are demand is not weak
- Total CPI growth fell marginally to 1.5%, as expected. Total inflation has been pushed down by a steep decline in electricity prices. Good for real income growth, and for consumption!
- **Implications**
  - » Core inflation remains just above the price target and September was close to NoBa's f'cast
  - » No substantial market reaction, NOK strengthened marginally just after the report

Manufacturing production retreated in Aug. Oil related close to peak?

Production slipped 1.1%, reversing the July jump. Annual rate moderate at 2.8%, flattening out



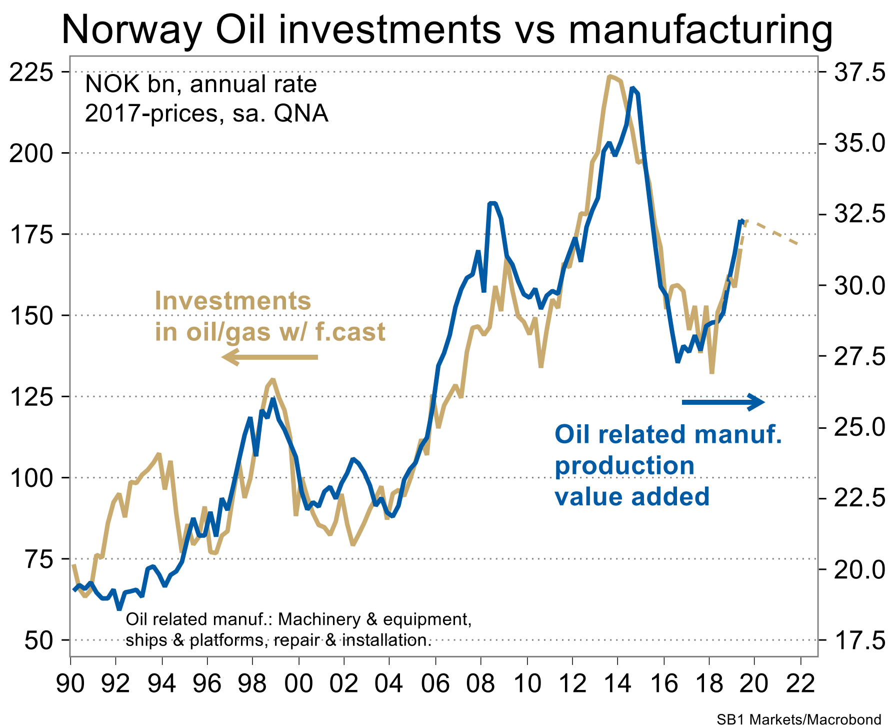




- Total manuf. production fell 1.1% in Aug, well below expectations. Underlying growth has slowed to 1.2% and the annual rate has flattened out, at 2.8% in Aug (smoothed)
- The upturn has primarily been driven by oil-related manufacturers, which are up 13.5% y/y. However, we assume the oil investments – and thus oil related production will (be close to) peak in H2
- Non-oil related sectors were flat through 2017/18 but has fallen marginally in 2019 – and is down 1.5% y/y
- Surveys have softened and point to weaker growth going forward

How large is the upside in oil related industries? Not much…

In H2, oil investments will probably be close to our 2020 estimate



- Production in oil related industries have soared since late 2017, closely correlated to the increase in oil investments, as reported in the National accounts
- Oil investments will probably come close to the local peak now – during H2 – at some 6% above the Q2 '19 level
- If correct – and if Norwegian manufacturers do not gains market shares from foreign competitors – oil related production will soon flatten out
  - » Neither Norges Bank's regional survey (in Q3), SR-bank's regional survey (Q3) nor SSB's manufacturing survey (Q2) signal an immediate halt in growth – while the PMI, which covers the whole manufacturing sector signal close to zero growth
- Some extra negative signals: Both manufacturing and power supply investments are expected sharply down in 2020, according to SSB's investment surveys for these sectors

Our main views

	Main scenario	Recent key data points
Global growth cycle	The cycle is maturing, in the real economy, markets, and the trade conflict is now doubt a factor behind the recent slowdown, especially in the manufacturing sector. Rich countries (DM) in the lead, more to go in most EM. Unemployment is low, wage inflation on the way up, not low vs. productivity. Most emerging countries (EM) x China are in recovery mode. Some hotspots EMs will get burned, as usual – but there are fewer EM imbalances than normal. Barring policy mistakes, the global economy is not yet rigged for a *hard* downturn. Investment rates are not far too high, few debt bubbles this time. **Still, growth has slowed to 3% from 4%, and we expect a further slowdown to 2.5% in 2020, even if trade conflicts are 'solved'. If ramped up, more downside risk**	The global composite PMI inched down just 0.1 p in Sept, to 51.2. The level points to some 3% GDP growth, as during the previous quarters. Global manuf. PMI has stabilised but remains weak and actual prod. remains sluggish while retail sales are slowly cooling
China	The governments' stimulus measures may have stabilised the economy, and surveys and data do not point to a hard downturn (rather, a stabilization). The invest/GDP ratio is still sliding down. Debt growth has slowed, and will not accelerate much even if authorities are trying to stimulate credit in order to compensate for the negative impacts from the trade war/previous tightening. Fiscal policy is also activated. Exports to US approx 2% of GDP, and a (so far) 10 % decline here is manageable. **However, a full scale trade and even more a tech/world hegemony war will hurt the Chinese economy**	The Sept PMIs far better than expected, and Markit's manuf. PMI is reporting decent growth. Both exports and imports are keeping up rather well, even if China is still reporting y/y decline in trade values, and exports to US is down 30% from the peak
USA	Growth has slowed, from well above trend. The employment rate is still trending up, and unemployment down, but wage growth is not accelerating. Price inflation is just marg. below target. No serious overinvestments but most sectors at/above trend and corporate debt is high. Business investments have weakened amid weaker growth in profits and trade war uncertainty. Recent consumption data are solid but may now be softening (and partly funded by lower, although still high savings). Housing mostly positive. Fiscal stimulus continues but not by much. The deficit is far, far too high, given the low unemployment rate. Recession risk is increasing, but still not overwhelming, short term. **Risks: Trump/trade/business investments**	Core CPI inflation flat at 2.4%, underlying growth at 3%. But producer price inflation slows, do not signal higher price pressures. Job openings are turning down, an early warning sign. FOMC were split on the Sept cut, no surprise. Consumer sentiment improves and is not weak
EMU	Growth has slowed and manufacturing data are worrying while services remain resilient. The labour market is still tightening, and labour cost infl. is back to a normal level. Investment ratios are above trend. Credit growth is accelerating, but still muted. Household savings are high, still consumption has kept up well. Policy: ECB has turned dovish but does not have that much ammunition left, barring a huge QE, and the ECB policy makers are split. Fiscal policy debate has turned. **Risks: Trade war (but less risk for a US/EU war after G7). Italy. Weak short term data signals a substantial further slowdown risk**	Industrial production probably recovered softly in Aug, trend steeply down. German exports dropped, surveys and exports orders indicate a much steeper decline. The ECBwas even more split than anticipated on the monetary stimulus package
Norway	Growth is still above trend but may soon be peaking. Unempl. is still declining, although at a slower pace. Wage inflation is accelerating. Oil investments are peaking in H2. Mainland business inv. not low anymore, will probably slow in '20. Mixed signals from the housing market, starts probably slowing. Electr. prices have taken the headline CPI down but core still slightly above target. Credit growth slowing (households) still above income growth, is spite of heavy regulations. **Risks: Debt, housing. A harsh global slowdown**	2020 National Budget slightly on the contractionary side, surprisingly. Core CPI inflation inched up to 2.2% in Sept, after slowing recent months

The Calendar

In focus: China Sept data, US housing, manufacturing and retail, Norges Bank's lending survey

Time	Country	Indicator	Period	Forecast	Prior
TBA	CH	Credit Growth CNY	Sep	1900.0b	1980.0b
Monday Oct 14					
06:00	SW	Unemployment Rate, Registered	Sep	--	3.8%
11:00	EC	Industrial Production MoM	Aug	0.3%	-0.4%
Tuesday Oct 15					
03:30	CH	CPI YoY	Sep	2.9%	2.8%
08:00	NO	Trade Balance	Sep	--	6.7b
10:30	UK	Average Weekly Earnings YoY	Aug	4.0%	4.0%
10:30	UK	ILO Unemployment Rate	Aug	3.8%	3.8%
11:00	GE	ZEW Survey Expectations	Oct	-26.9	-22.5
14:30	US	NY Empire Manufacturing Survey	Oct	0.5	2
Wednesday Oct 16					
10:30	UK	CPI Core YoY	Sep	1.7%	1.5%
11:00	EC	CPI Core YoY	Sep F	1.0%	1.0%
14:30	US	Retail Sales Advance MoM	Sep	0.3%	0.4%
14:30	US	Retail Sales Core (Control Group)	Sep	0.3%	0.3%
16:00	US	NAHB Housing Market Index	Oct	68	68
20:00	US	Fed's Beige Book			
Thursday Oct 17					
06:00	SW	Valueguard House Prices MoM	Sep		0.2%
09:30	SW	Unemployment Rate, LFS	Sep	7.0%	7.4%
10:00	NO	Norges Bank Lending Survey	3Q		
10:30	UK	Retail Sales Core MoM	Sep	0.0%	-0.3%
14:30	US	Building Permits	Sep	1345k	1419k
14:30	US	Housing Starts	Sep	1320k	1364k
14:30	US	Philadelphia Fed Business Outlook	Oct	7.8	12
14:30	US	Initial Jobless Claims	Oct-12	215k	210k
15:15	US	Manufacturing Production	Sep	-0.3%	0.5%
Friday Oct 18					
01:30	JN	Natl CPI Core YoY	Sep	0.5%	0.6%
04:00	CH	Investments ex Rural YoY	Sep	5.5%	5.5%
04:00	CH	Industrial Production YoY	Sep	5.0%	4.4%
04:00	CH	Retail Sales YoY	Sep	7.8%	7.5%
04:00	CH	GDP QoQ	3Q	1.5%	1.6%
16:00	US	Leading Index	Sep	0.1%	0.0%
Monday Oct 21					
03:30	CH	New Home Prices MoM	Sep	--	0.6%

- **China**
  - » **GDP growth** might have slowed somewhat from Q2, however, neither surveys nor 'hard data' suggest any sharp downturn
  - » **Industrial production** has lost some steam the past 2 month. Still, PMIs do not signal any further slowdown
  - » **Retail sales growth** has been stabilizing recent months, according to our volume estimate, while the official value y/y rate slips
  - » **Investments** are rising steadily, at a lower pace than nominal GDP
  - » **Credit** is accelerating slightly, fueled by a lift in shadow banking activity
- **US**
  - » Both **retail sales** and total private consumer have been softer so far in Q3, from a rapid growth in H1. Not surprising, given lower consumer confidence and slightly softer income growth
  - » **Housing starts & permits** soared in Aug, we expect a correction in Sept
  - » **Manufacturing production** has recovered marginally the two past months but the trend is down, and all surveys are heading down. Sept production and the first **Oct surveys** released this week
- **EMU**
  - » **Industrial production** most likely recovered softly in August, we estimate +0.3% m/m, based on countries reporting this far. Orders, surveys signal a further decline
- **Sweden**
  - » **Unemployment** has turned steeply up and employment plummets. So far, LFS has reported the most abrupt upswing, will registered unempl. follow up?
- **Norway**
  - » **Norges Bank Q3 lending survey** may confirm a slowdown in household credit demand as interest rates are slowly increasing - even if house prices are accelerating moderately?

Source: Bloomberg. SB1M est. in brackets. The key data points are highlighted

In this report

Global + Auto sales

- Global macro data somewhat more downbeat
- Retail sales, manufacturing production slows; global trade declines
- DM orders are falling – and investments peaked in Q2?
- Global auto sales down in September due to Europe (technically), China

China

- Exports are trending up, imports are flat, none are signalling any crisis

USA

- Core inflation unch at 2.4%, the highest in 11 y
- Producer price inflation slows, core PPI down 0.3% in September
- No major news from the Fed meeting minutes, the FOMC is divided
- UoM Consumer sentiment recovers more than expected
- Small businesses' optimism cools, still miles above PMI/ISM (activity)
- Unfilled vacancies down from peak, an early sign of a cooling labour market?
- Jobless claims another tick down last week, no signs of weakness yet
- Nowcasters are signalling some 2% growth in Q3 as well

EMU

- Industrial production prob. recovered modestly in Aug but trend sharply down
- German manufacturing orders do not point to any recovery in production
- German exports are declining but just softly, imports are stalling

UK

- Manufacturing production remains sluggish, still more downside risk?

Sweden

- Core inflation steady in September, the Riksbank f'casts an acceleration

Japan

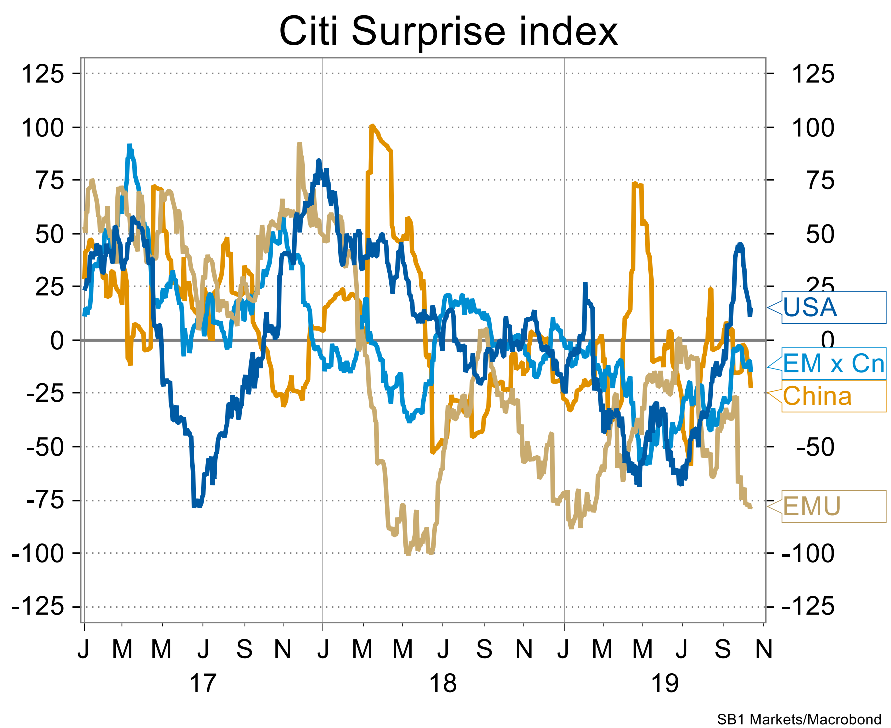
- Core machine orders are heading up, thanks to domestic demand

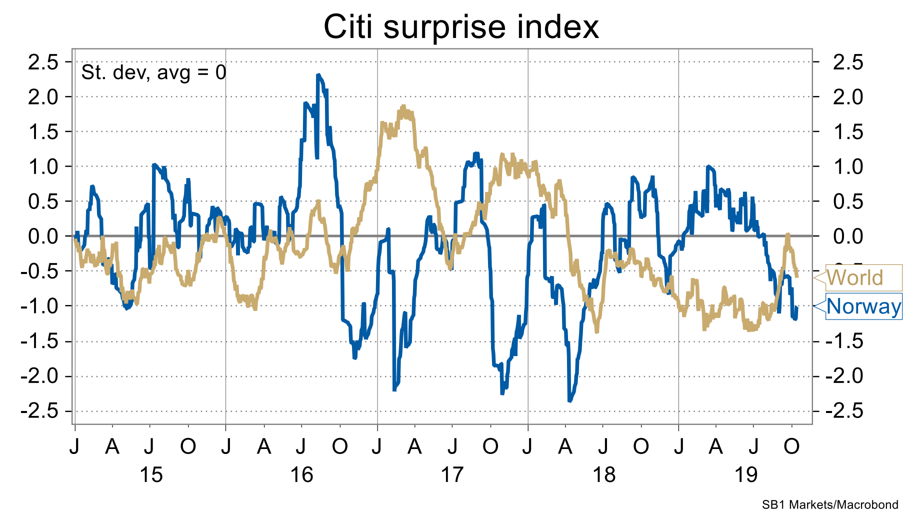
Norway

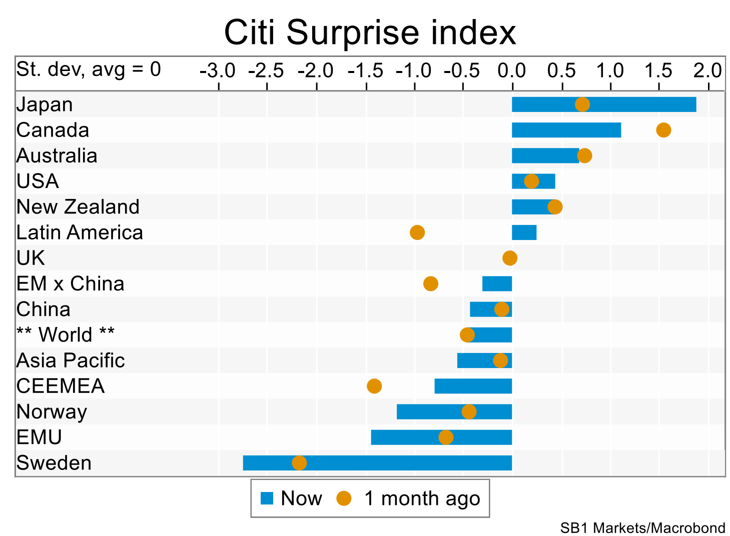
- A tighter 2020 budget than expected (and not just on paper)
- Core inflation edged up to 2.2% in Sept, total inflation eased to 1.5%
- Manufacturing production retreated in Aug. Oil related close to peak?
- GDP growth retreated less than expected in Aug, a solid Q3 so far
- The Financial News Index steady in Sept, history revised up

Global macro data somewhat more downbeat, again

Less positive news from US and deteriorating EMU data sent the global index down from 'neutral'





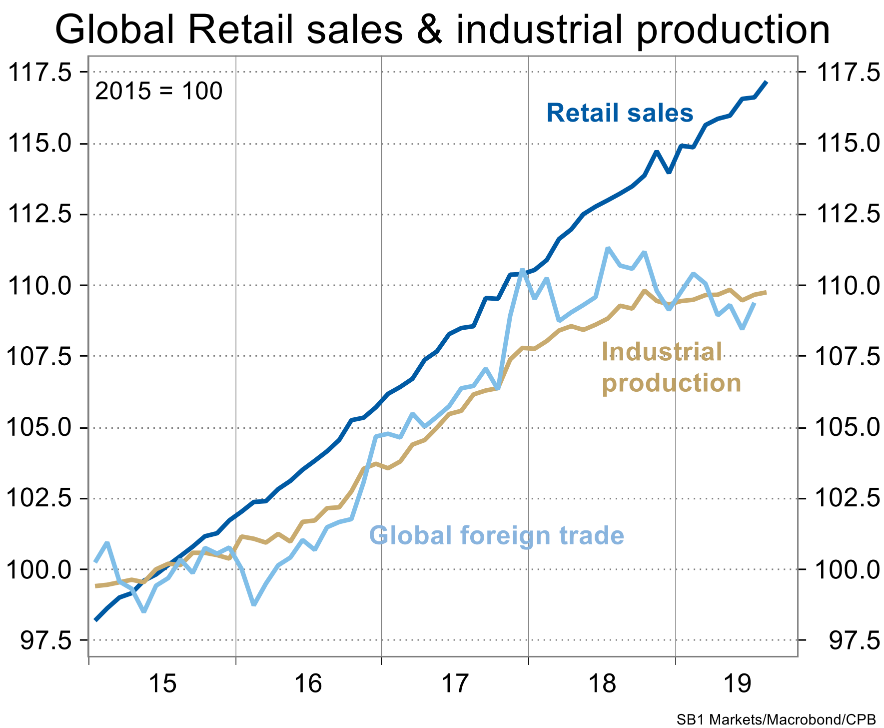


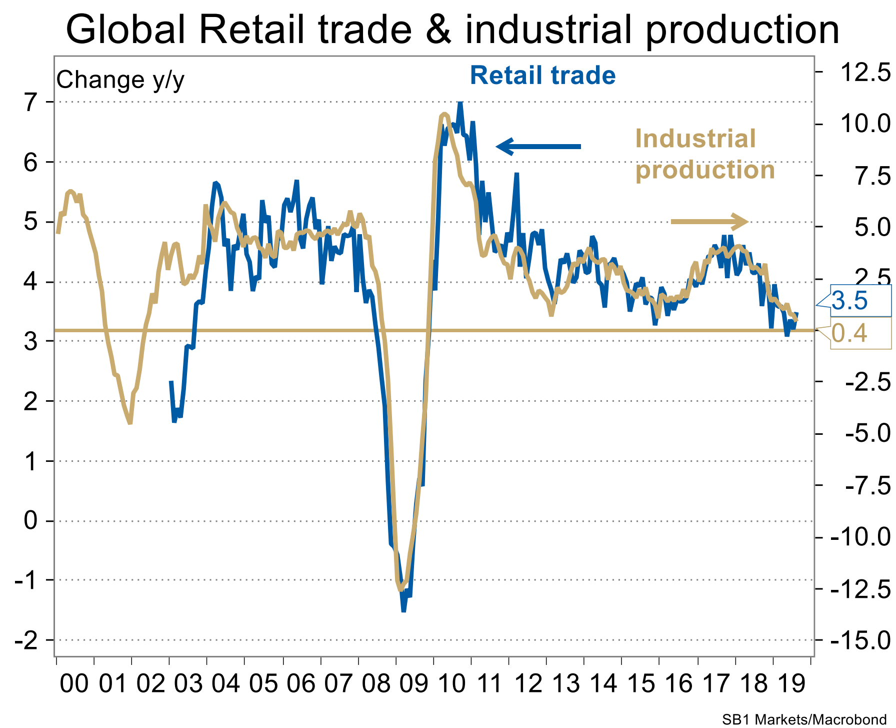
- The global surprise index climbed to a 'neutral' level for the first time this year in mid-Sept. Since then, data have been slightly more disappointing, in sum
- US data flows have been beating expectations the past month. The past 2 weeks, a weak ISM, lower PPI inflation and a fewer job openings than expected have sent the index down
- EMU data are the most disappointing since early 2019, pulled down by weak Sept PMIs
- China just below neutral, along with other EM
- Norwegian data are more disappointing than the world in general, we are not sure we agree

Surprise-indices measure the difference between economists' expectations and the actual outcome over a 3 month rolling window

Retail sales, manufacturing production slows; global trade declines

Global trade flows rose in July but are no doubt heading down. Manufacturing production stalls

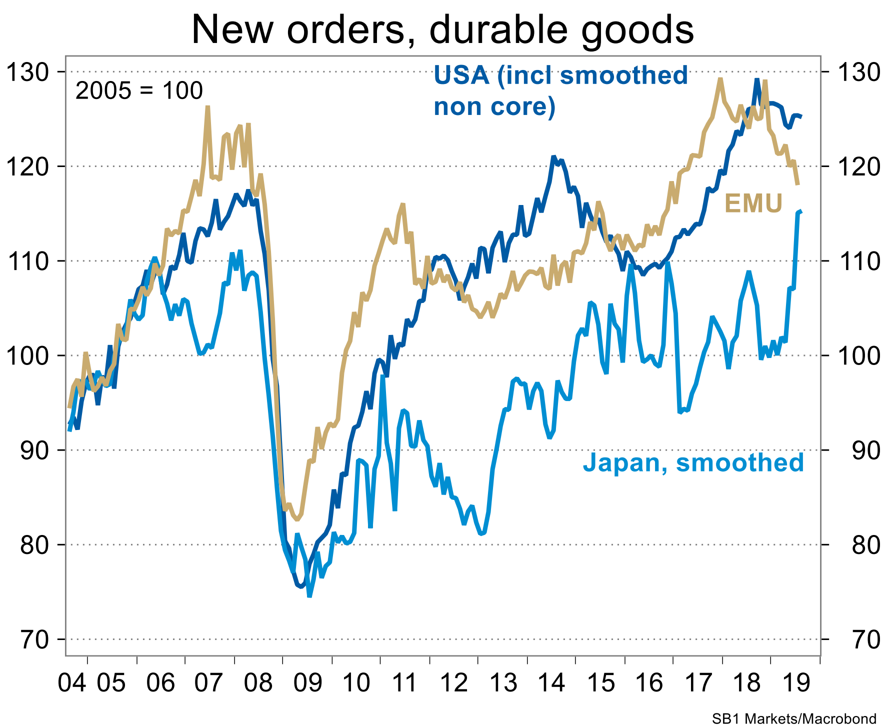


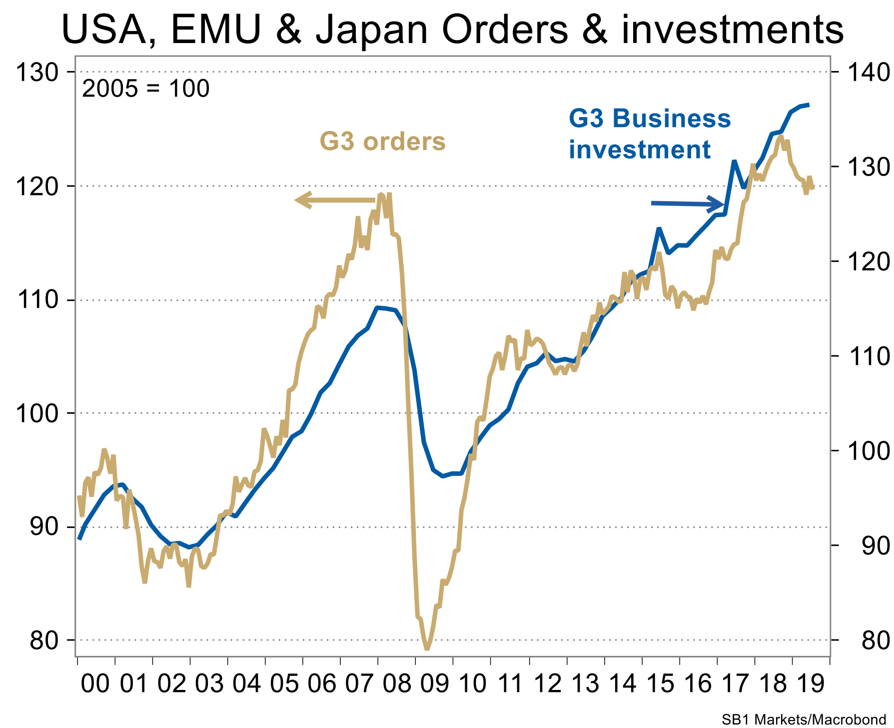


- **Global industrial production** most likely inched up some 0.1% m/m in Aug (our prelim. estimate). The overall trend is no better than just marginally upwards, growth has slowed substantially. Global business surveys signal a modest decline
- **Retail sales** increased by 0.5% m/m in August, based on our estimate. Growth has come down, more or less in tandem with manufacturing production (given the normal correlation between the two, retail sales are less volatile than retail sales). Even so, consumption is still supporting the global economy
- **Global foreign trade** increased by 0.9% m/m in July (with our seasonal adjustment) but the decline in June was more abrupt than previously reported, down 0.8% m/m vs 0.5%. Trade flows are trending down, at a 2% pace since last summer, as trade uncertainties curb demand. The slowdown is rather broad based, Emerging Asia ex China and Lat. Am and Africa are the weakest links in the chain

DM orders are falling – and investments peaked in Q2?

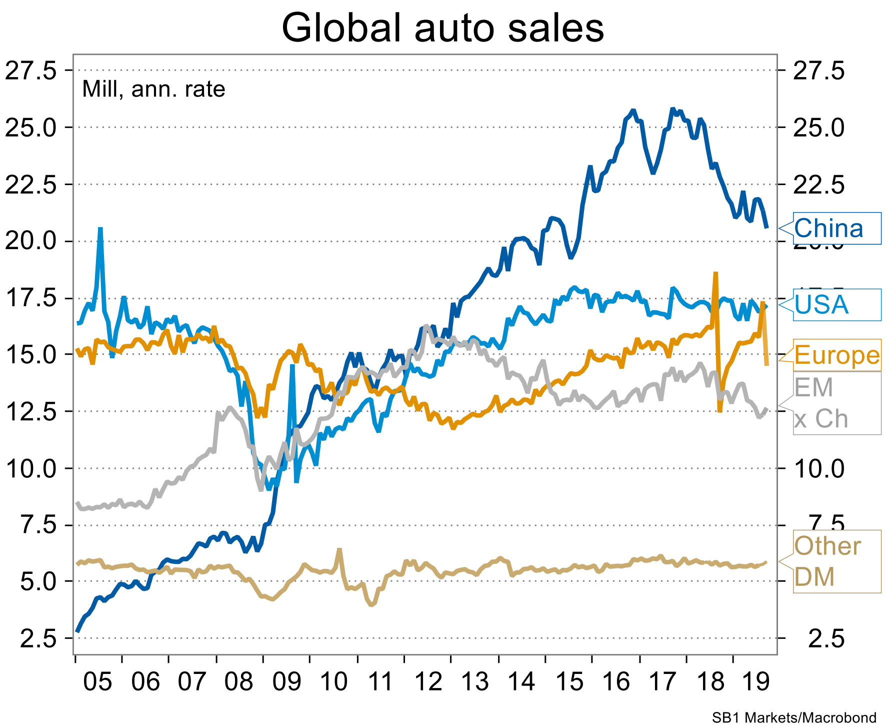
Mixed G3 order inflows; EMU falls steeply, US slowly weakening, Japan recovers

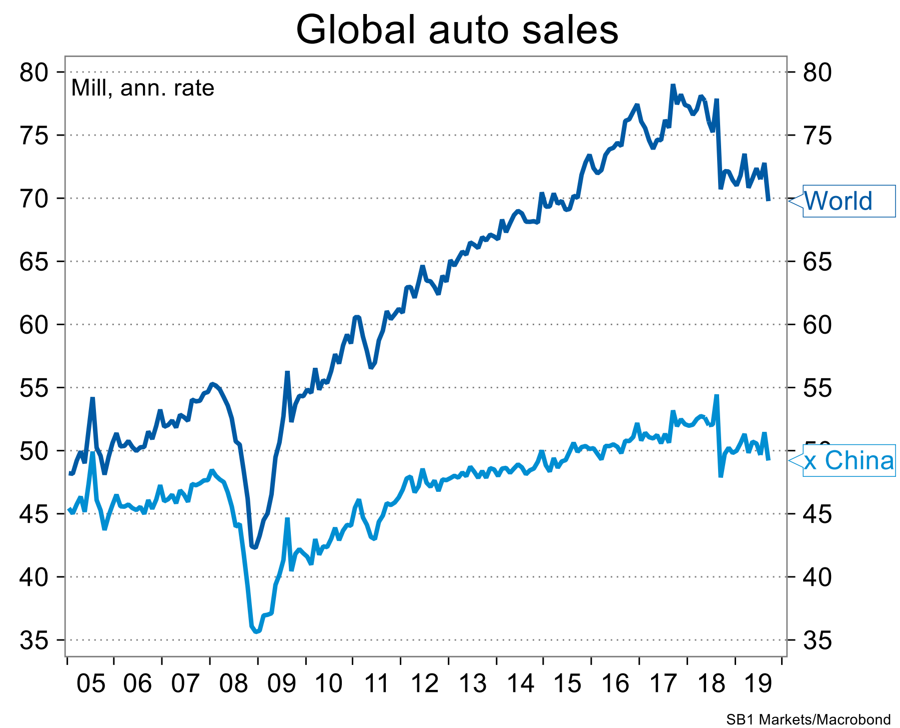




Auto sales sharply down in Sept, mostly 'technical' but China still sagging

European sales down 16% m/m from the Aug spike, adjustment to tighter emission rules

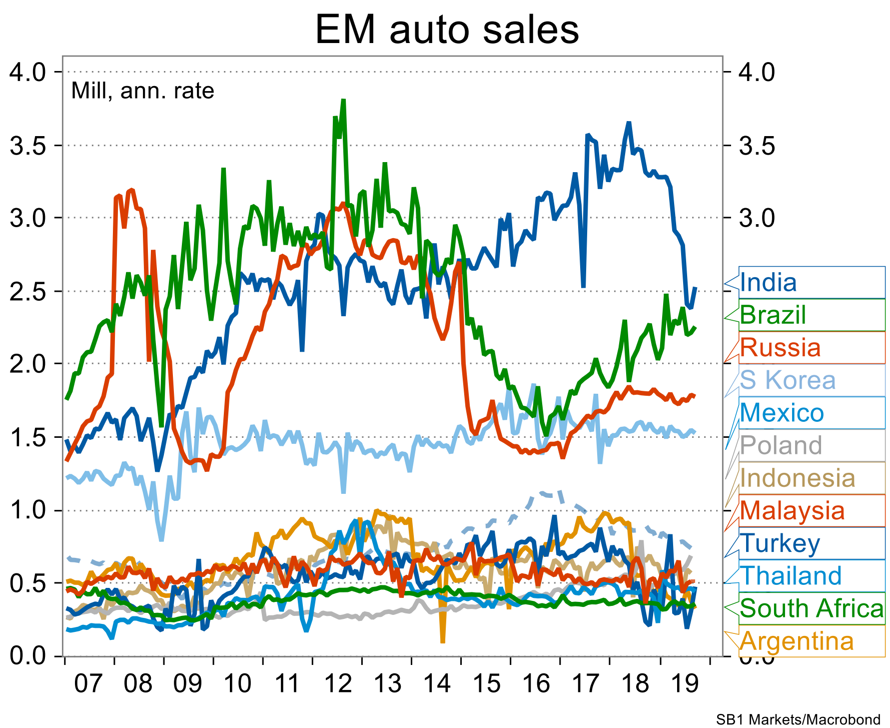


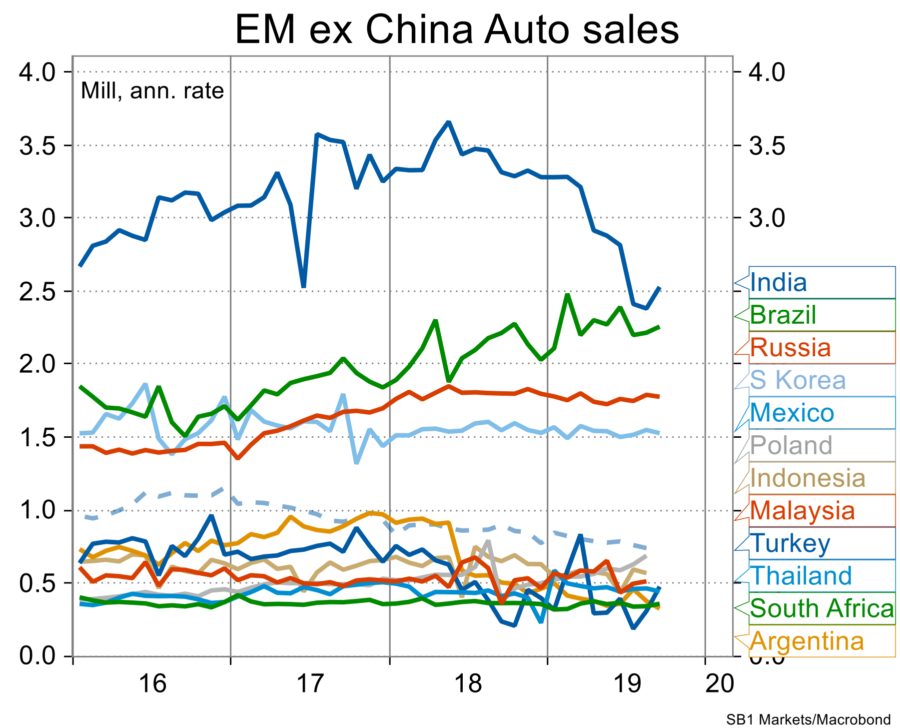


- Global sales fell 4% m/m in Sept (from +2% lift in Aug), but are down just 1.3% y/y – as sales 'collapsed' in Sept '18 – and have remained low ever since, and sales are down some 8% from the level last summer (at the lowest level since 2015). Data are preliminary, also Chinese sales
- Sales in Europe fell sharply from a high level in Aug when inventories for cars complying with old emission standards had to be cleared, with substantial rebates. Sales in Sept were most likely far below 'normal'. Before the Aug spike, sales had recovered from last years emission standard downturn. US sales rose, as did sales in other DM
- Chinese sales fell further 4% m/m in Sept, and are still trending down – and are down almost 20% from the peak last year.
- Auto sales in EM ex. China rose marginally in Sept but the level is low, following a long journey downwards, -23% from the peak 7 y ago, -14% from early 2018! Indian sales rose m/m but are down 30% from the '18 peak

EM x China up in Sept but is trending down, strength nowhere

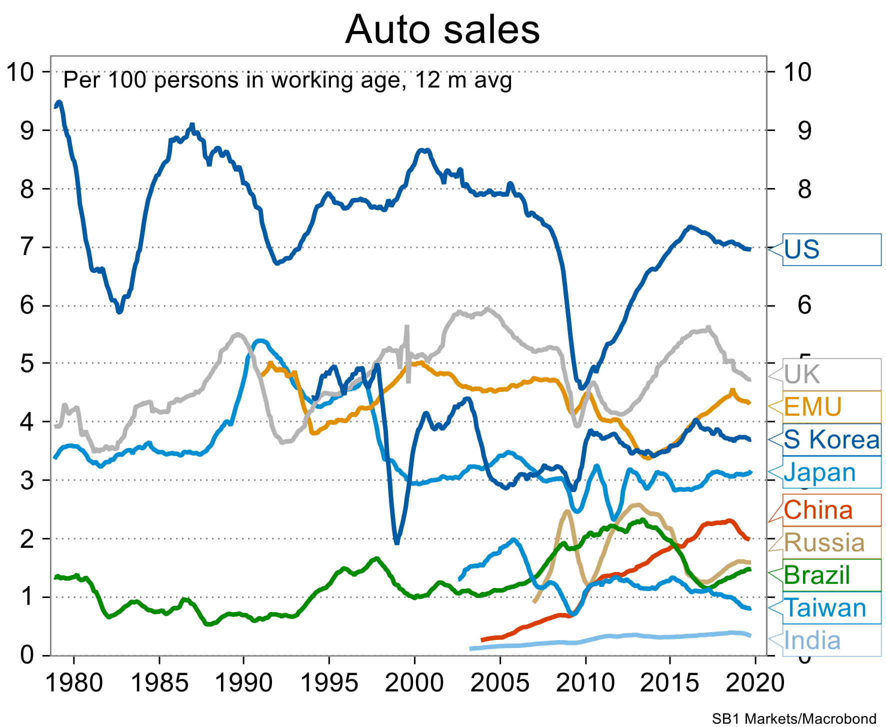
Indian sales may have stabilised, at a low level. Brazil, Russia flat, at mediocre levels

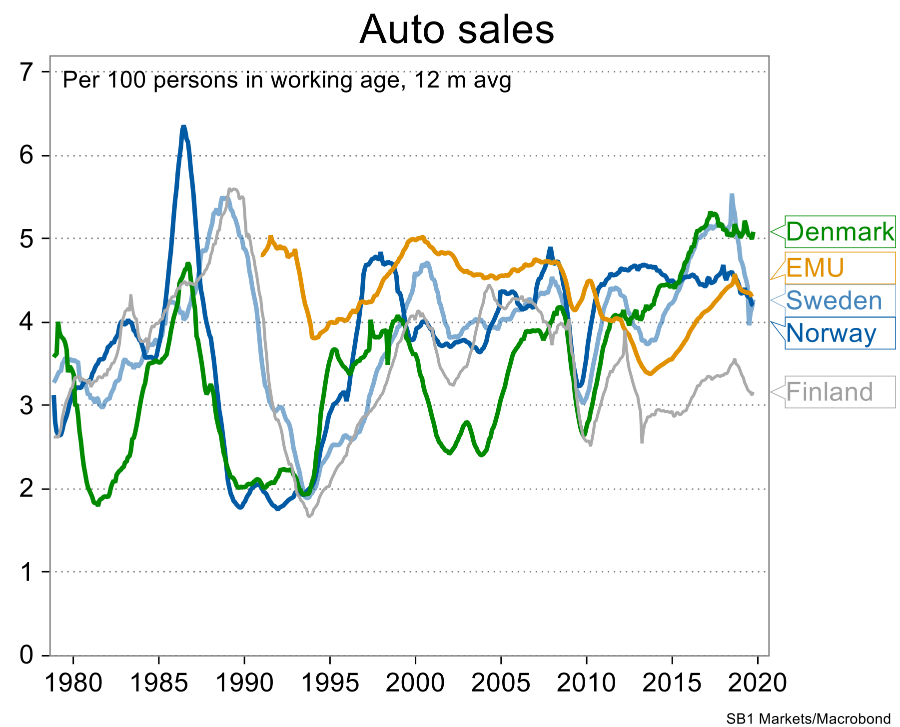




- Indian sales rose m/m i Sept but the levels is way below the 2018 peak (close to -30%)
- Brazilian sales have flattened and Russia is still below the (low) local 2018 peak. Sales are sluggish in South Korea & even more in Mexico. Poland the only bright spot
- Turkish sales have been extra volatile recently and were ‘record’ low in July but has recovered somewhat in Aug/Sept. Argentina has fallen to 12th (and bottom) of our EM universe, from a 5th place in the ranking in 2017/early 2019 (down 60%)

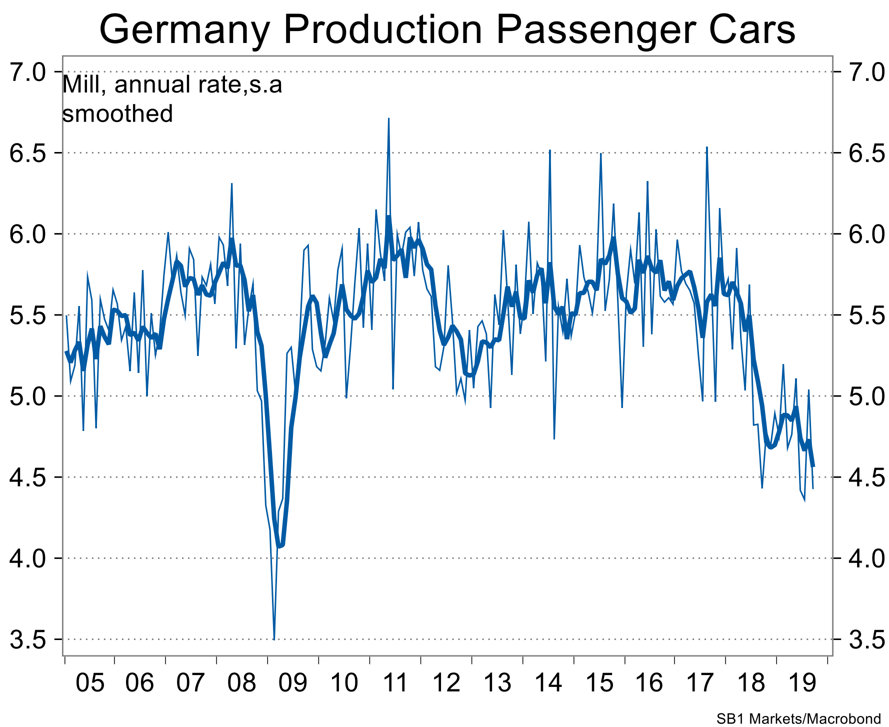
Sales are sagging almost everywhere – in the Nordics too

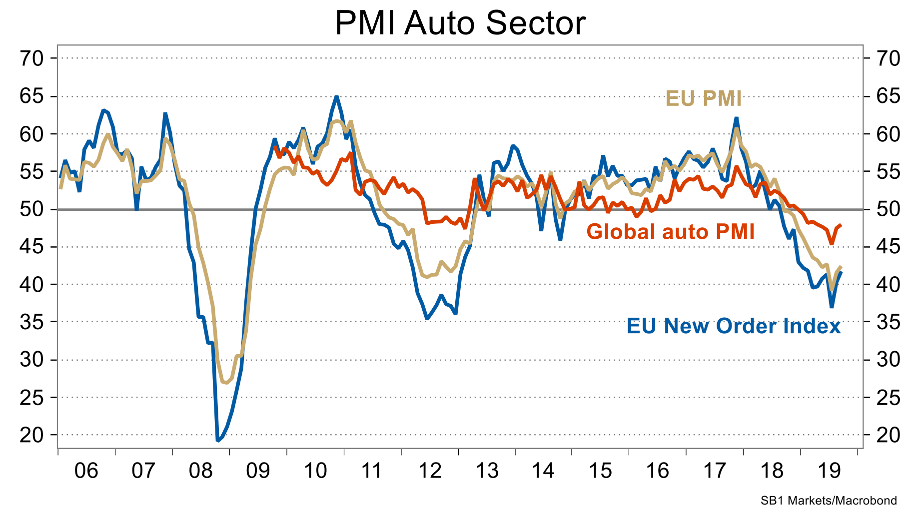


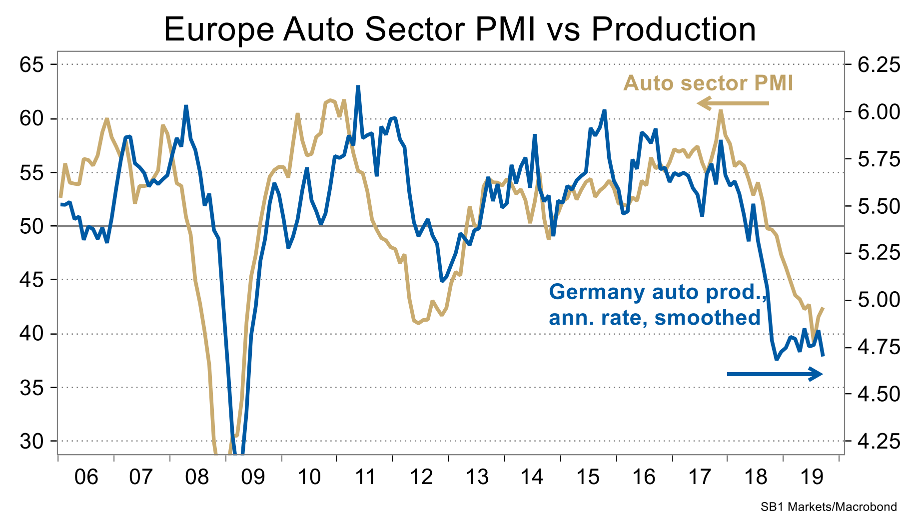


German auto production fell again in Sept, 20% below a 'normal' level

German auto production is remarkably weak given German, European or global auto sales



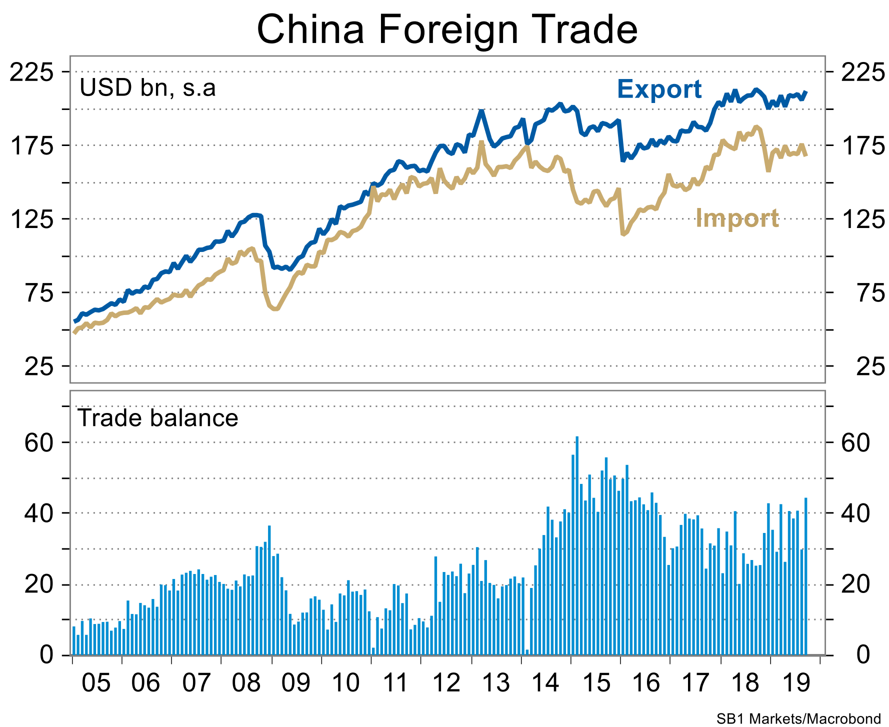




- German auto production is down approx 20%, an incredible number, given auto sales in Germany, EMU or even the world, which have fallen far less than 10% from the peak
- The European auto sector PMIs are not reporting any recovery. The European auto PMI is much weaker than the global auto PMI

Exports are trending up, imports are flat, none are signalling any crisis

Exports are down 3% y/y but have trended up since last Dec, both in value/volume



- Exports were reported down 3.2% y/y in USD in Sept, as expected, down from -1% in Aug. Still, exports rose 3% m/m and have been slowly been trending up since the local bottom last Dec. If exports keep up at the current level in spite of the escalating trade war (the skinny trade truce agreed upon at Friday just prevent the announced extra tariffs from Oct 15), China will soon report growth y/y. Export volumes are trending up too, and the volume was probably close to all time high in September!
  - » Exports to the US fell further in Sept and are down USD 8 bn, or 20% since 2018 (equalling 4% of total exports). Exports to other regions have compensated most of the decline in export to US, especially to the rest of Asia. Still, growth has slowed in most directions
- Imports were down 8.5% y/y in Sept, expected -6%. Imports fell by 5% m/m (following +4% m/m in Aug). The trend is slowly up since Dec '18, but it is quite flat recent months. In volume terms, imports are down 10% from the peak last year, a substantial decline but not that unusual – and import volumes are not far below a reasonable long term trend line, and does not signal a sharp weakening of domestic demand
- The trade balance was stronger than expected, at USD 40 bn (44 bn, seasonally adj, highest since 2016!)

SpareBank 1 MARKETS

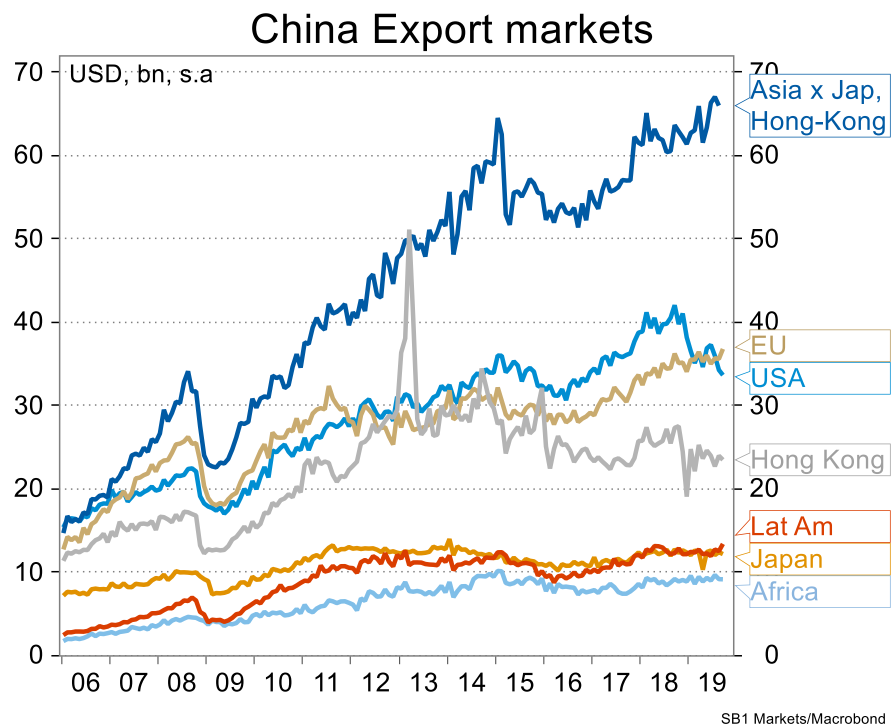
Export surveys are signalling a modest decline in exports, no collapse

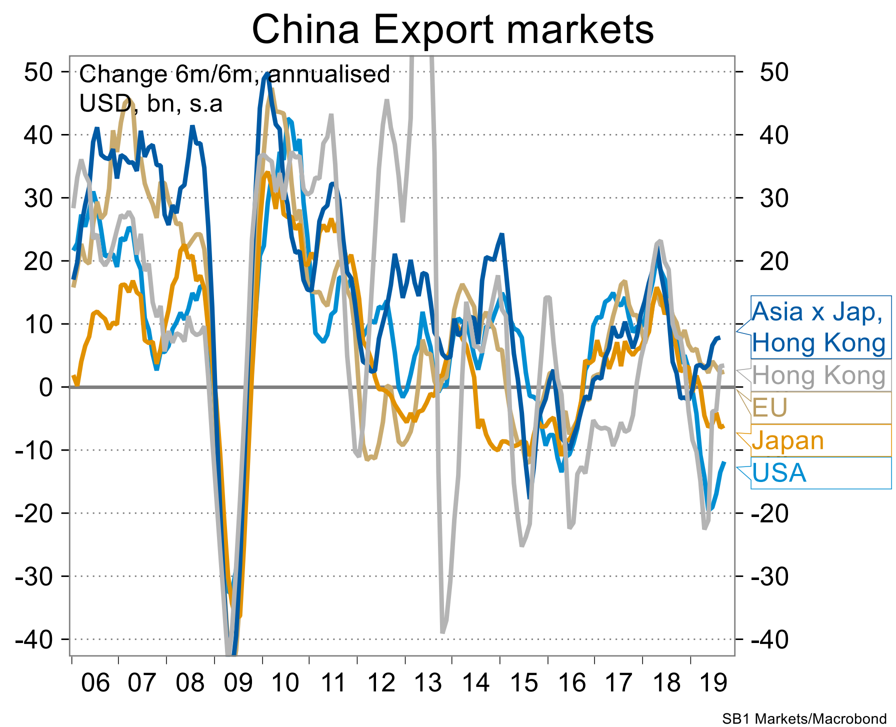
A slowdown/marginal decline has been signalled, as in 2011, ’12, ‘13, and ’15/16

- .. And actual export volumes fell in 11/12, were flat in 13 and fell in 2015 – without creating huge problems in the Chinese economy
- Now, exports are slightly down y/y but has been trending up since last December

Exports to the US down 30%, but there is a ROW

Exports to H-K down too, but exports to most of the rest of the world are still on the way up

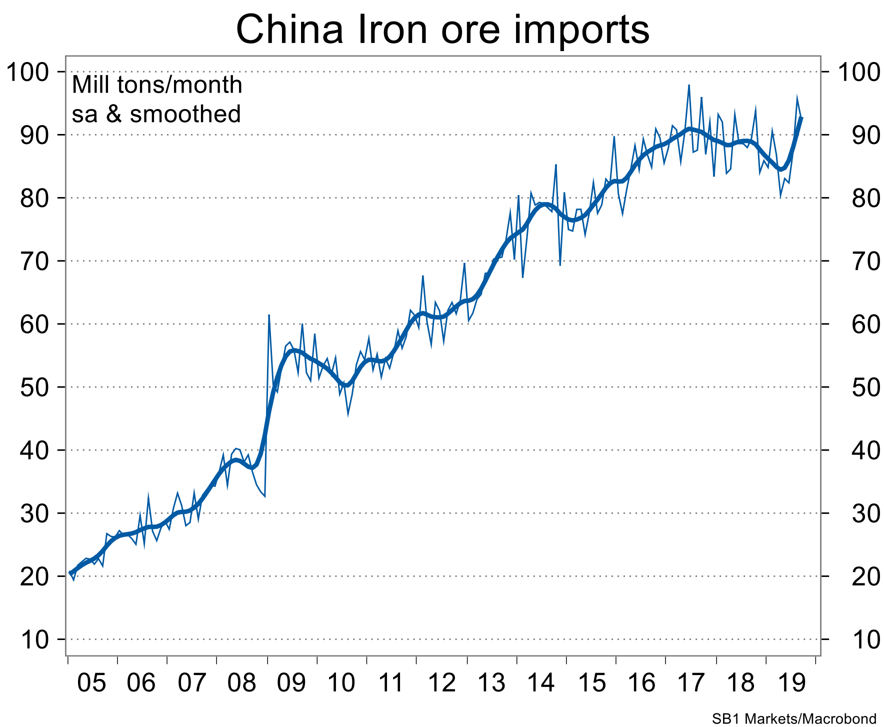


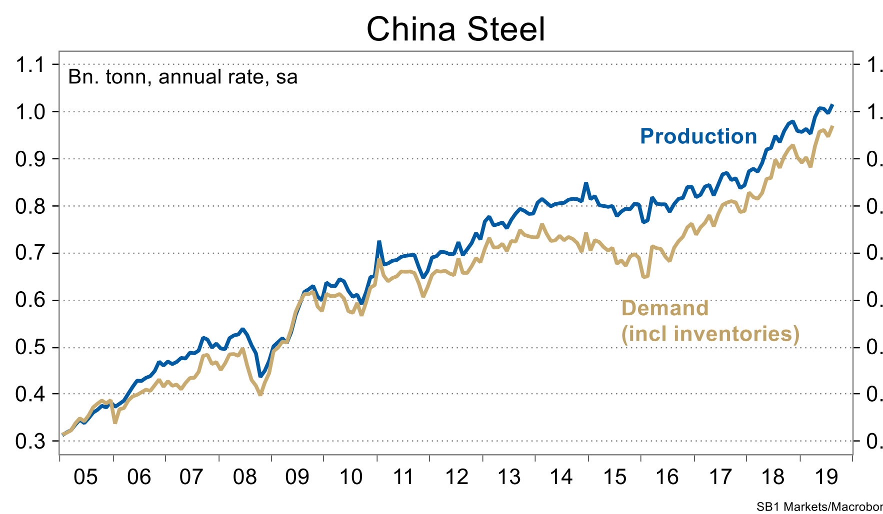


- Exports to the US are hurt by the tariffs, now down some 30% from the peak in early 2018, equalling 4% of all Chinese exports. Tariffs were lifted substantially from Sept 1 and more tariffs will be implemented in Dec (but the announced increases from Oct 15 is now put on hold, following the trade deal last Friday. A further decline in exports to the US must be expected
  - » Exports to the US equalled 18% of total Chinese goods exports (and exports to EU 16%, rest of Asia 48%, all before US tariffs)
  - » Total exports equal some 20% of GDP, exports to the US 3.6% of GDP – now down 30% from the peak, shaving a gross 1% from GDP (however, dampened by lower need for imports as inputs for these exports, and the impact of redirections of exports). The total trade surplus in volume terms is up, as imports have fallen – and net trade is now supporting Chinese growth
  - » The real economic risk for China & elsewhere: Trade uncertainty is hurting investments as companies may postpone investment decisions until the dust settles – and both Chinese and foreign company are reallocating from China to other countries. Some households may become worried too

Iron ore imports back to all time high in Aug/Sept

Net steel exports is trending down, domestic demand even more up than production

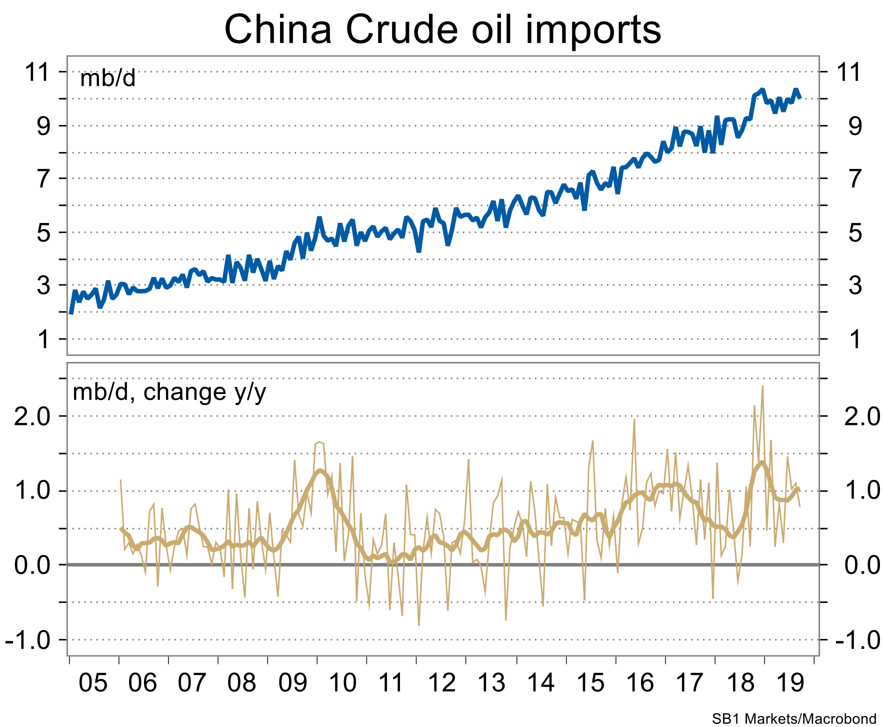


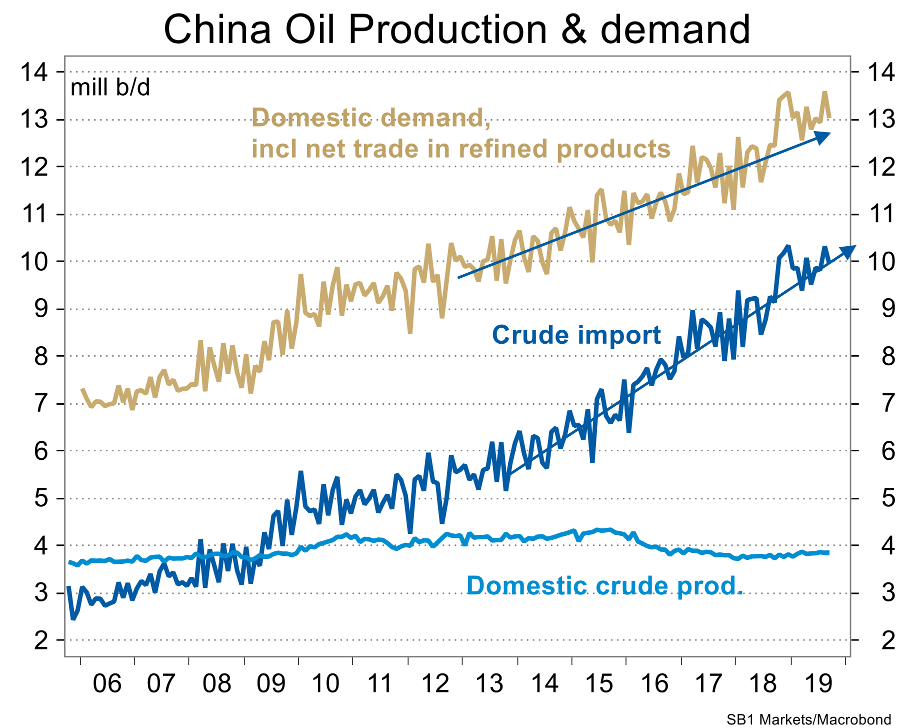


- Iron ore imports have been dragged down due to production problems in Brazil. Following a 10%+ surge recent past 3 months, imports are back at a record high level – which is needed, given a record high level of crude steel production (and record high domestic demand)
- Net steel exports equals some 6% of Rest of World production, probably too high. However, 3 years ago it equalled 13%!!

Oil imports (and demand) still on the way up

Crude imports are volatile short term but are trending up by approx. 1 mb/d per year



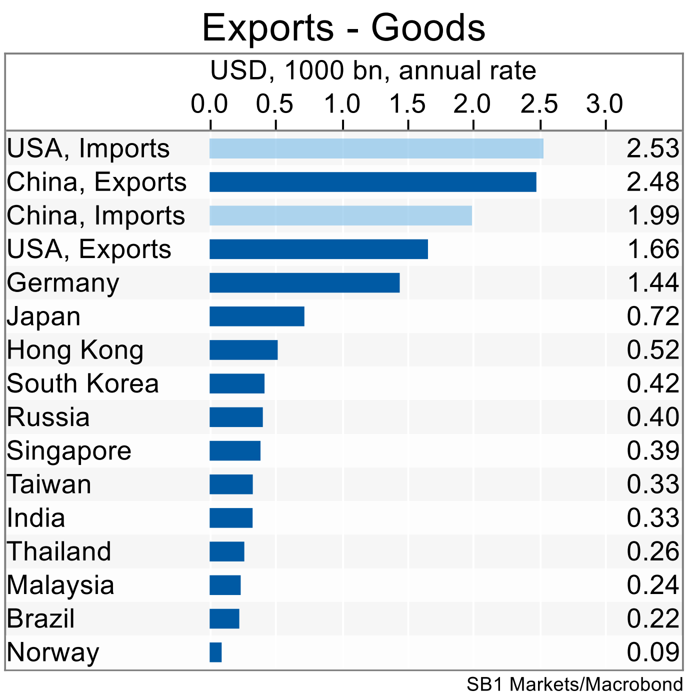


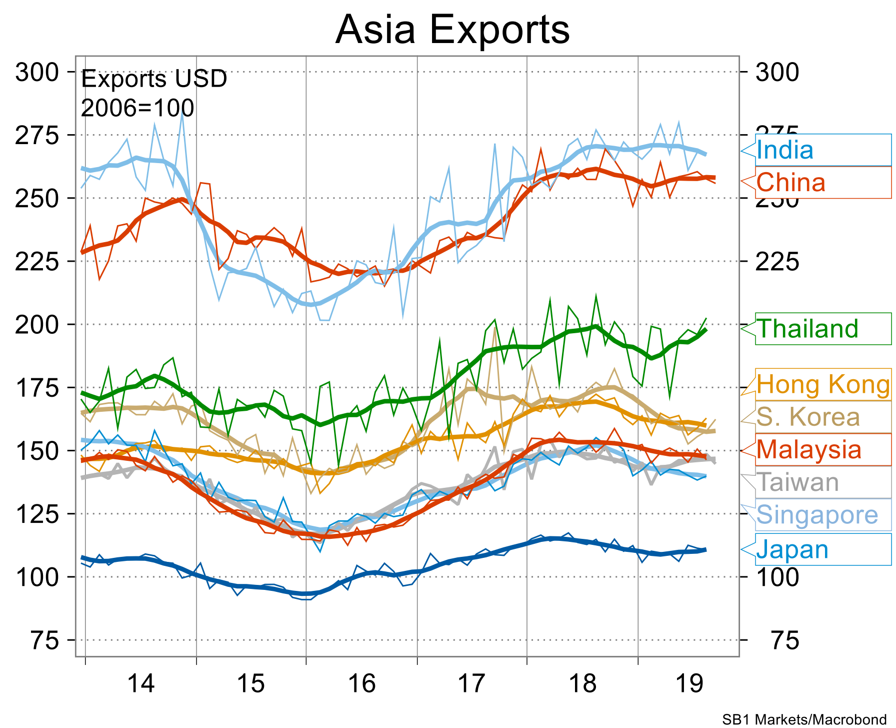
- Crude oil imports do not yield, and are up 1 mill b/d y/y - quite steady

SpareBank 1 MARKETS

Not many bright Asian export spots

Exports from Thailand, Japan are trending up, most others down

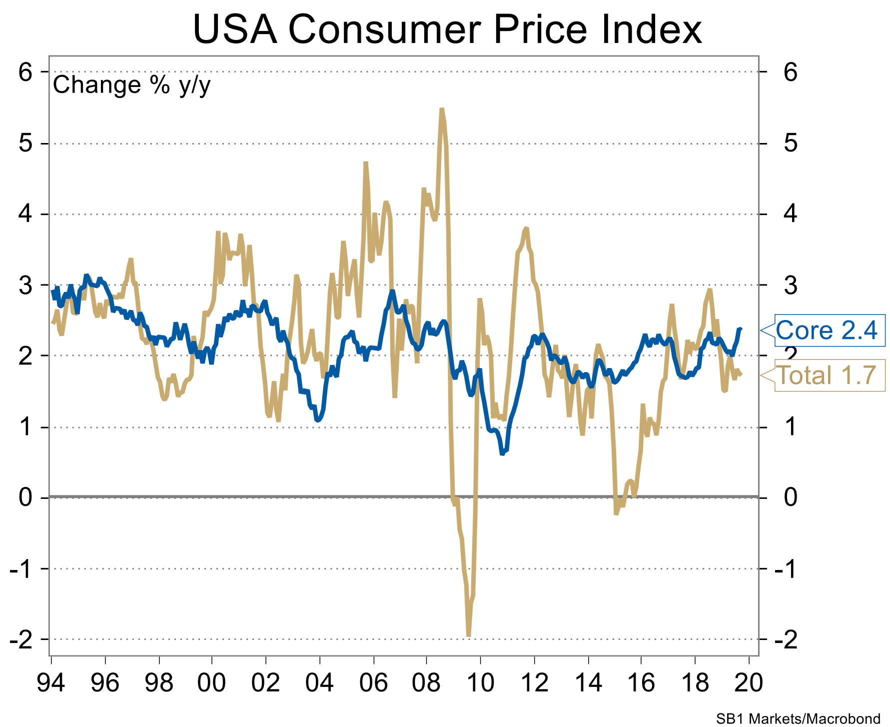


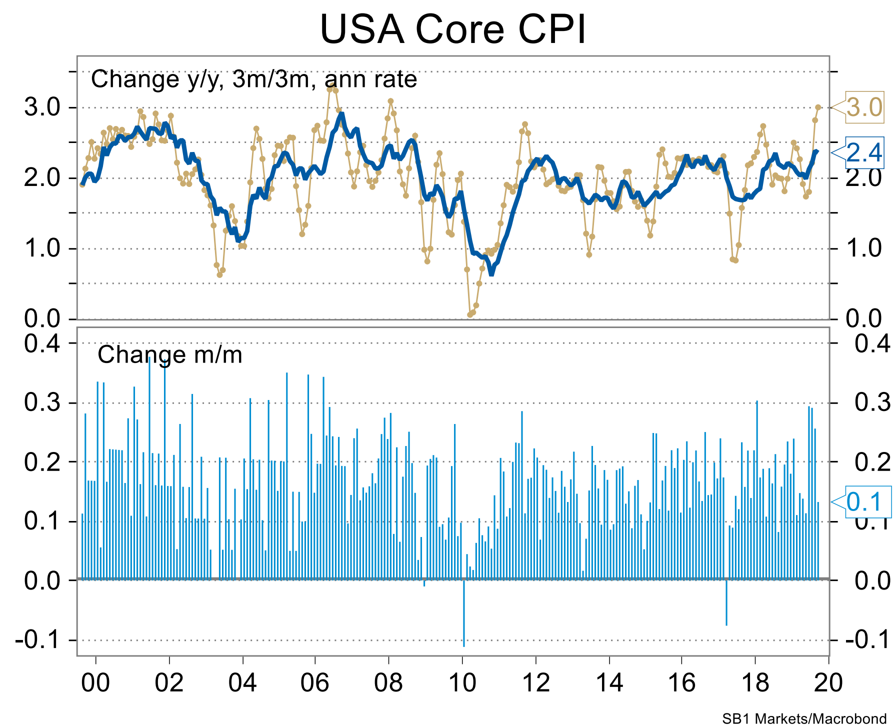


- China is of course the world's biggest export country (55% larger than the US!) – and the 2nd biggest importer!
  - » China will probably take the pole position in imports too, in some few years time

Core inflation unch at 2.4%, the highest in 11 years

Core CPI up just 0.1% m/m in Sept, but underlying growth at 3.0%

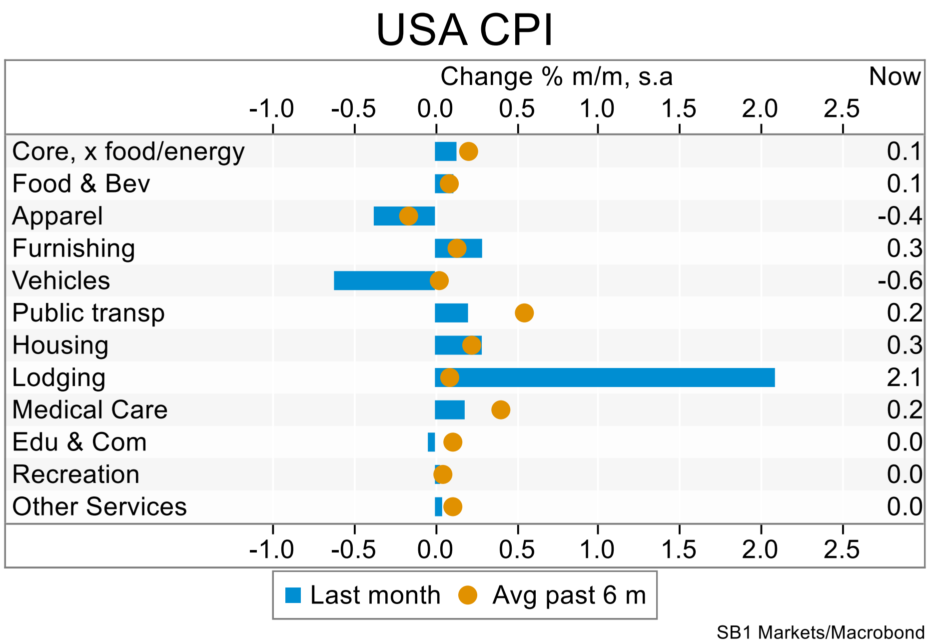


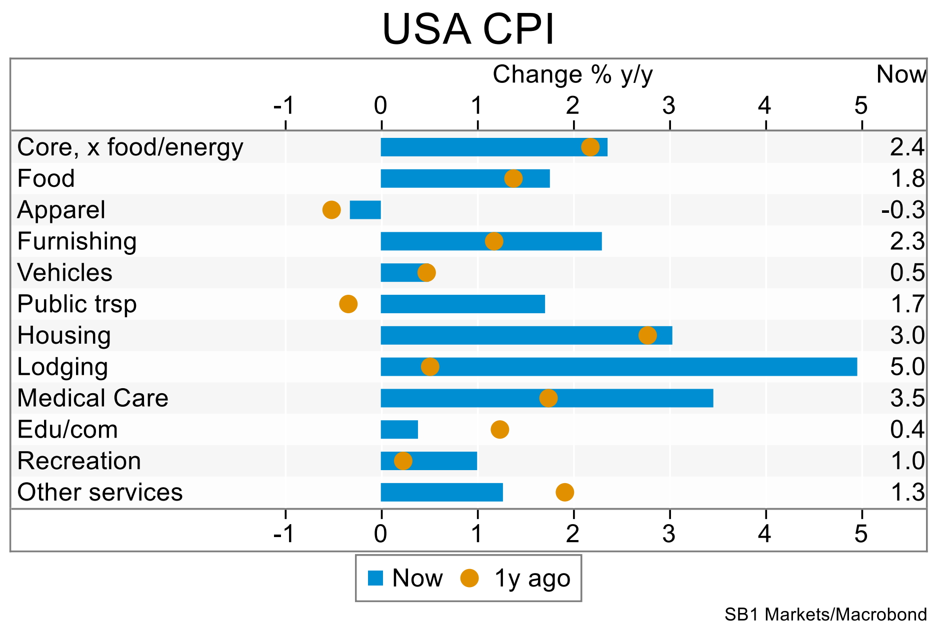


- Core CPI increased by just 0.13% m/m in September, after growing strongly the 3 prior months. The annual rate held steady at 2.4%, the highest since 2008. Underlying growth accelerated to 3.0%, may be signalling a lift in the annual rale. However, we doubt that inflation will increase much from this pace, as producer price and inflation models indicate that inflation may be peaking now. But it is not 'too' low, at least according to the CPI index
  - » Fed preferred price measure, the core PCE (the consumption deflator) is up 1.8%, below Fed's 2% price target
- Headline inflation fell marginally to 1.7%. Inflation has stabilised after being pulled down by declining energy prices

Lodging prices drove inflation up but most sectors are higher than 1 y ago

Prices are increasing in all sectors y/y (but clothing) – and accelerating in 7 of 11

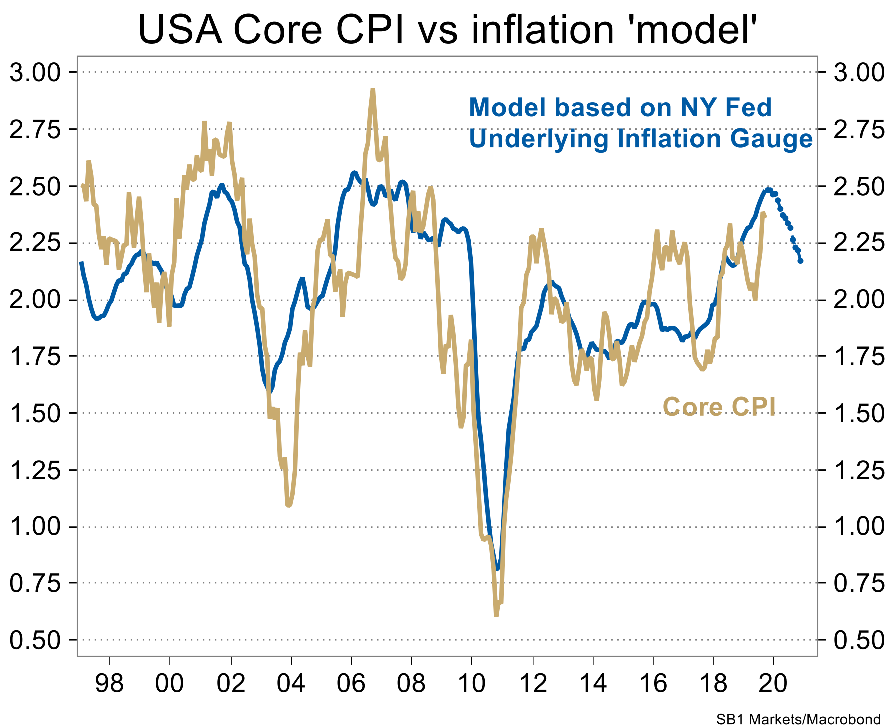


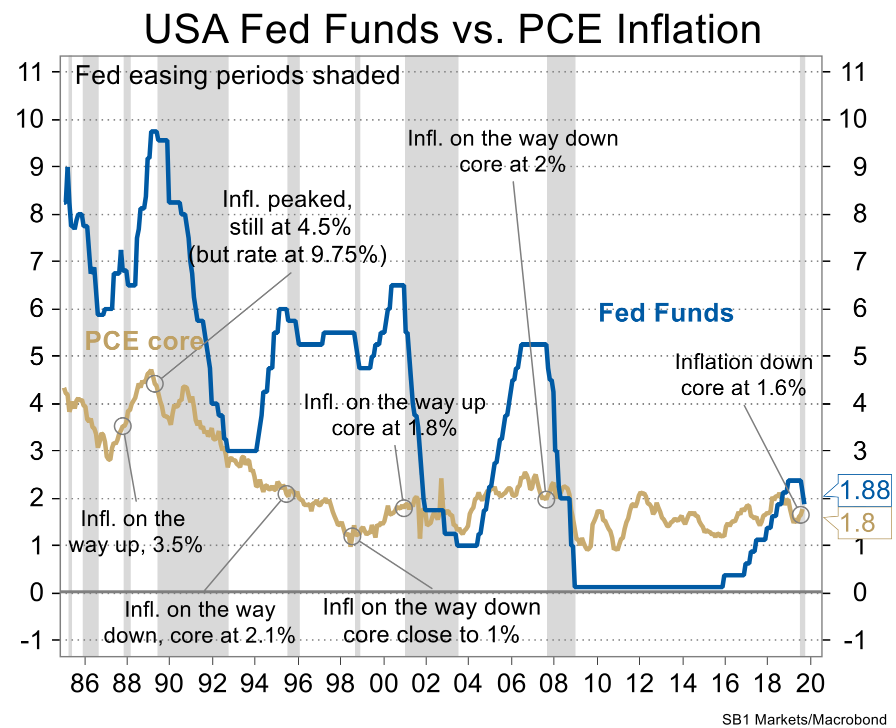


- Prices are increasing faster than 1 year ago in 7 of 11 sectors, slowing in just 2 sectors
- Higher prices on lodging, medical care and housing (rents & services) are boosting annual inflation
- On the downside in Sept: 2. hand vehicle prices fell – surprisingly (not confirmed by auction prices). Clothing prices fell too, but that's 'normal' (these prices are down y/y)

NY Fed's inflation model suggests that inflation is close to peak

The model signals 2.5% inflation this autumn, and a slowdown thereafter



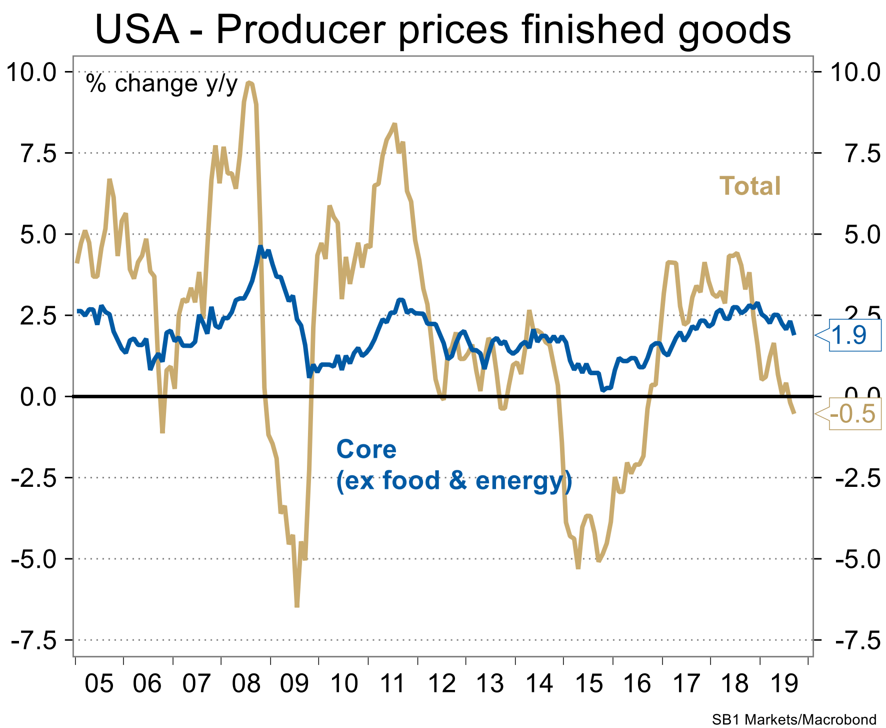


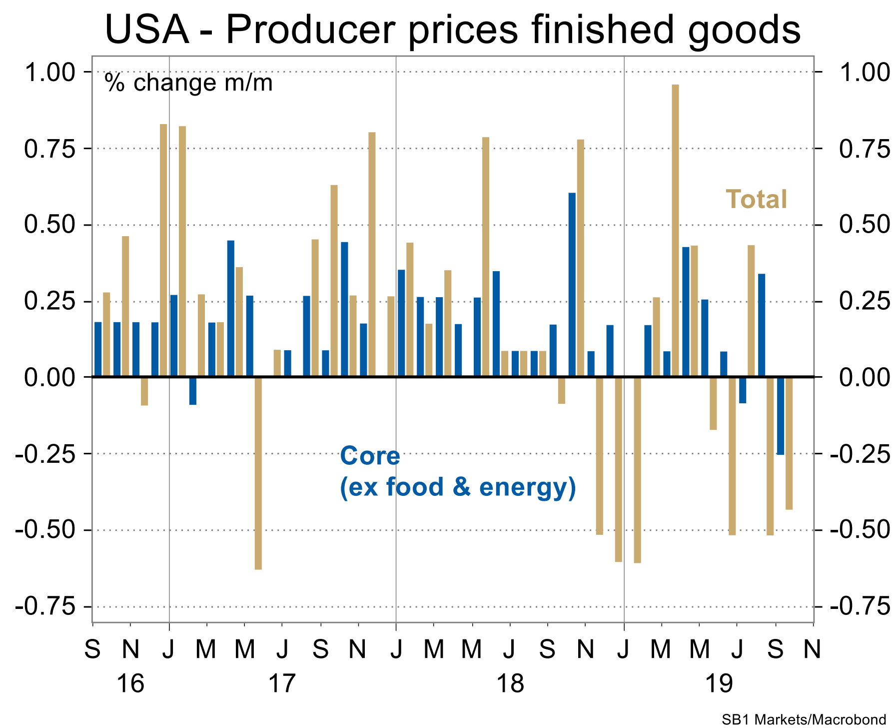
- The NY Fed's Underlying Inflation Gauge model includes a wide range of macroeconomic and financial components in addition to some CPI components. The UIG model leads the actual inflation rate by some 15 – 20 months. The model now signals somewhat lower inflation than it did some months ago (lower energy prices is probably one element) and does no indicate much higher inflation than today
- The personal consumption expenditure price deflator (PCE deflator) is the Fed's preferred inflation measure, not the CPI. The core PCE (ex food, energy) was up 1.8% y/y in August, below Feds inflation target at 2% - but underlying growth is up 2.4%
- Fed's actual rate setting has not been well explained by actual inflation during the past two decades. (Wage inflation is a far better indicator). The present PCE inflation rate may be low enough to 'justify' Fed's interest rate cuts (but not the CPI!) The economy – taking care of the 'dual mandate', full employment - will anyway decide Feds action from here – and the trade war of course

SpareBank 1 MARKETS

Producer price inflation slows, core PPI down 0.3% in September

Core finished goods inflation fell to 1.9% y/y in Sept, total PPI inched down 0.5% y/y

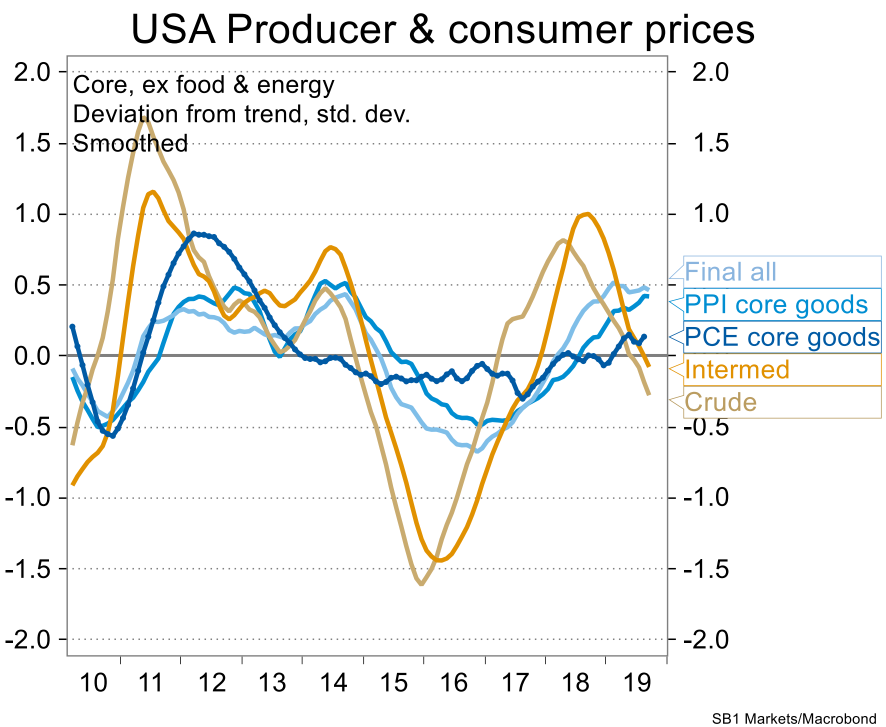


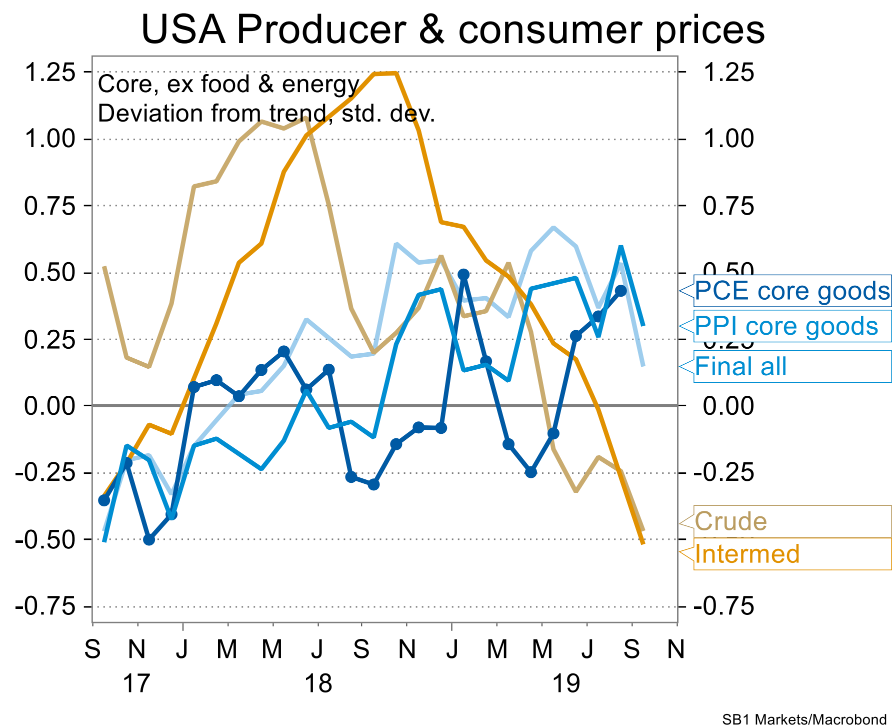


- Core finished goods x food & energy PPI surprisingly fell 0.3% m/m in September, 0.5 pp below expectations. Monthly growth has been meagre recently and the annual rate dropped to 1.9% in Sept, a 0.4 pp decline
- Headline PPI dropped 0.4% m/m. The annual rate fell to -0.5%, it has been brought sharply down by lower energy prices the past year
- BTW, when the Fed started hiking the Fed funds rate, core PPI was 0.3%, and total PPI was down 4.5% y/y

Crude, intermediate good prices (PPI) down, final goods following

And then consumer prices – producer prices do no longer signal much higher PCE inflation

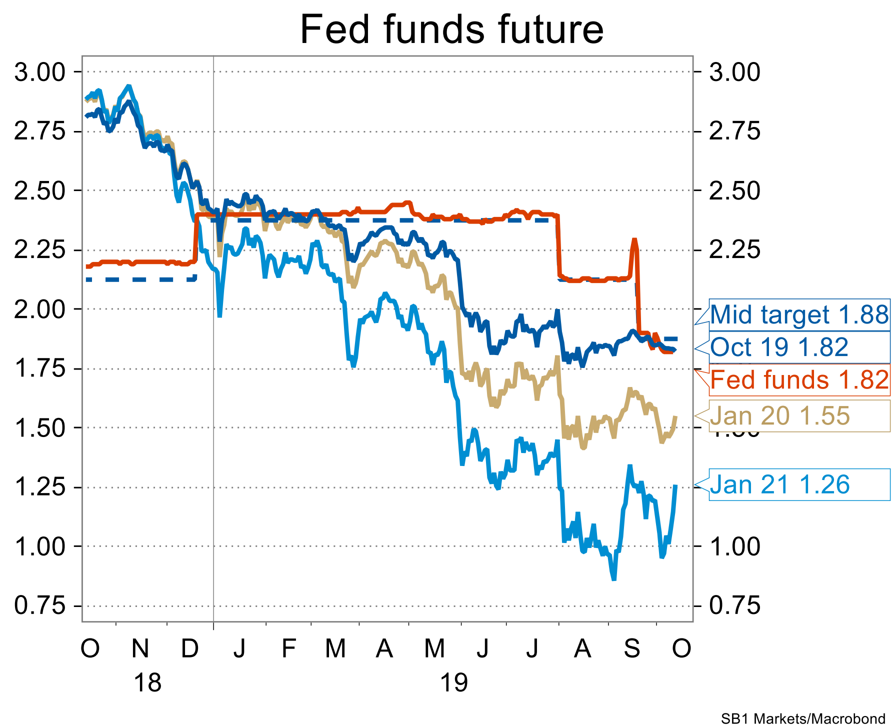


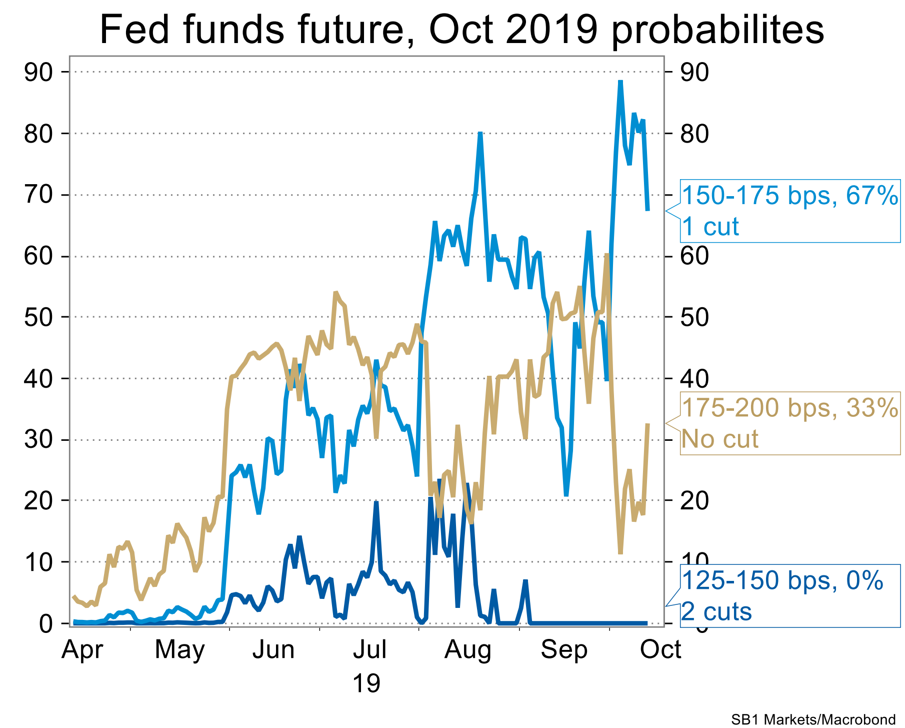


- Crude (core) PPI prices are heading steeply down, as are intermediate goods prices. Core consumer goods prices (at the producer level) fell in September and will over time turn south if prices at earlier stages do not recover
  - » Short term, there might be <u>some</u> upside risks vs. goods prices at the consumer level but not much

No major news from the Fed meeting minutes, the FOMC is divided

The cut was based on a 'risk management' assessment, as macro data had not deteriorated

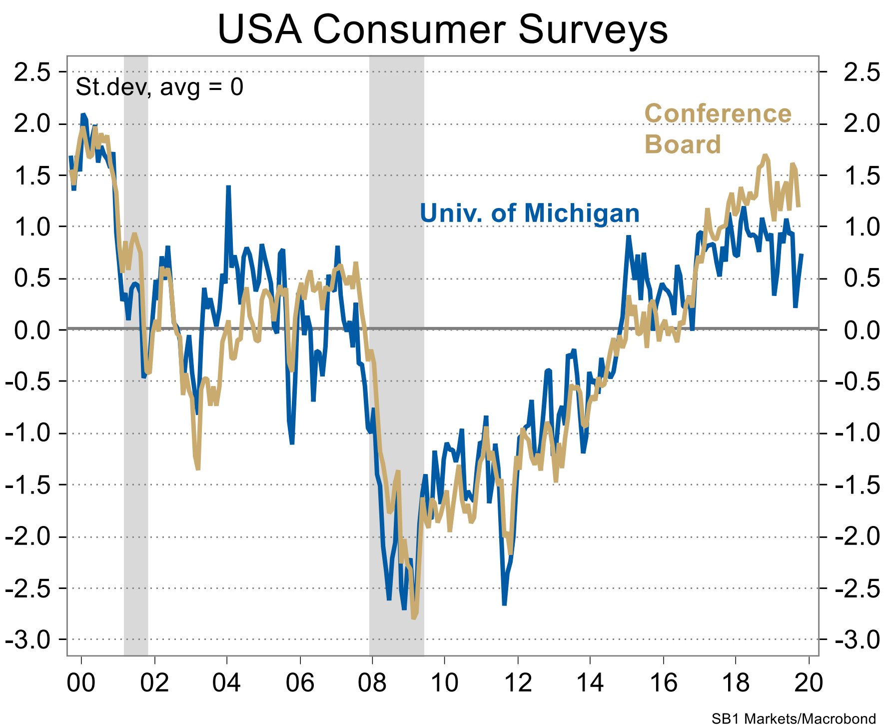


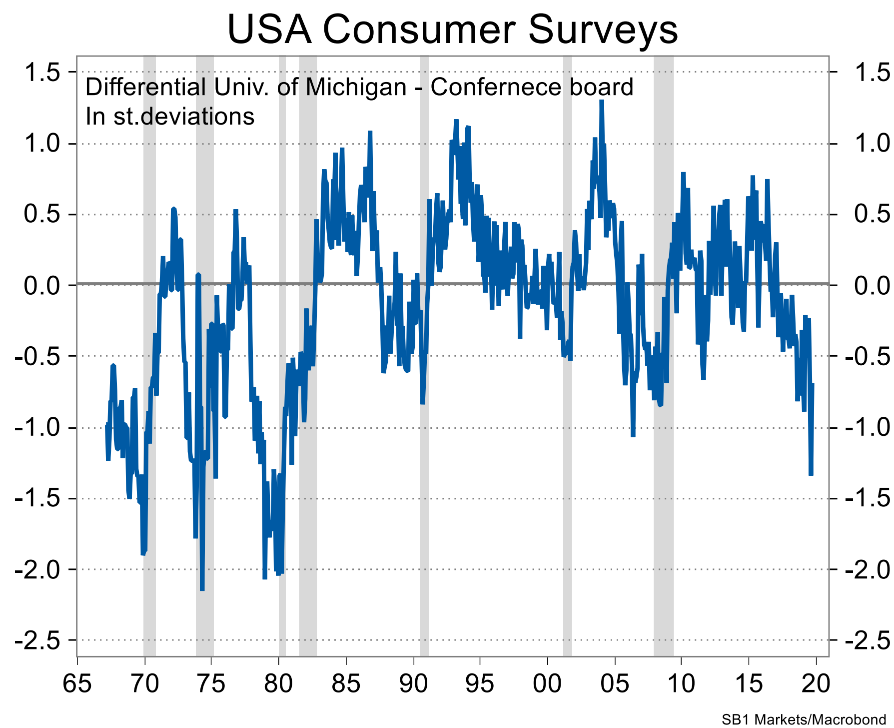


- Minutes from Sept 18 meeting once again underlined the lack of consensus at the FOMC. 7 members voted in favour of a 25 bps cut, while 2 members voted for an unchanged interest rate, and one member preferred a 50 bps cut
  - » Most members argued that downside risks to the growth outlook had become more pronounced since then July meeting, primarily due to the persistent trade dispute, and larger than the risk for inflation overshooting at the upside. The two who disagreed with the cut emphasized that economic data in general did not justify an interest rate cut (we can't say we disagree with this!), . Some also noted that market pricing indicated a more accommodative policy than they found to be appropriate
  - » In a speech on Tuesday, Powell announced that the Fed will soon start to buy short dates Treasuries bill in response to the recent funding issues in the money market. Powell emphasized that this is not equal to a reintroduction of QE (which was designed to lower long term interest rates). At Friday, Fed announced a USD 60 bn/month purchase Treasury bill program, more than expected
- The minutes did not reveal much new information from the June meeting. Market reactions were muted, market rates edged up Wednesday, we assume on trade deal optimism. A cut on Oct 30 is now expected by some 70% probability (it came down Friday)

UoM Consumer sentiment recovers more than expected

Confidence picked up further in Oct, more than half of the Aug drop has been reversed



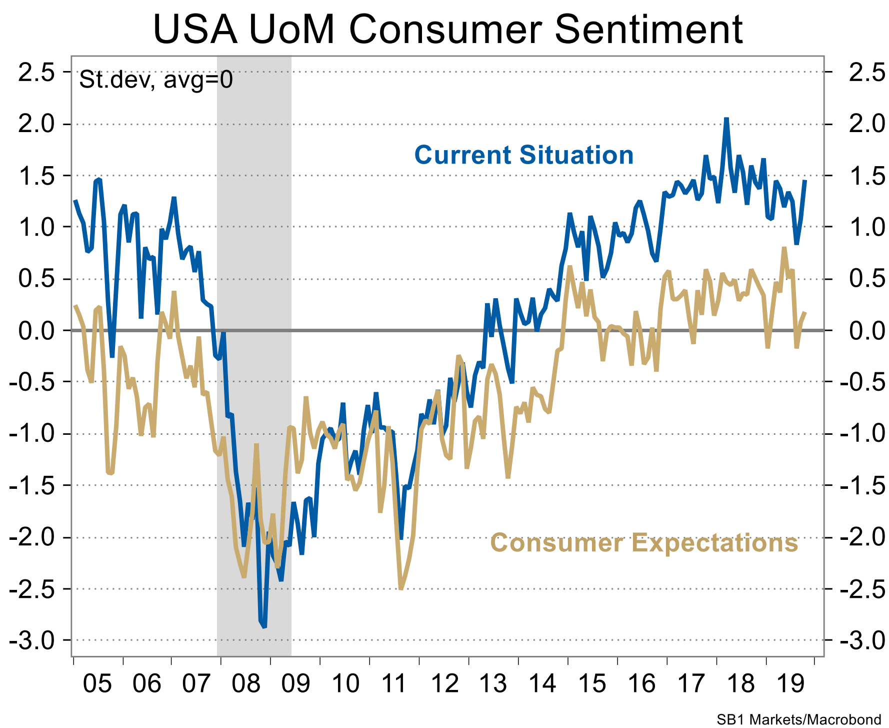


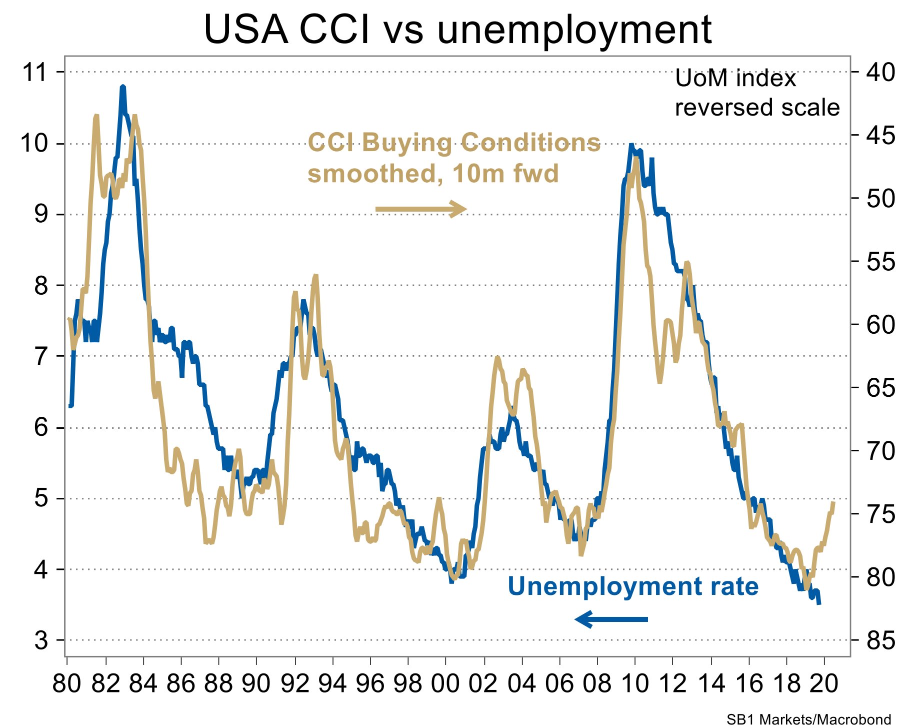
- University of Michigan's sentiment survey climbed to 96 in October, far above expectations (at 92). The index is just 2.4 p below the July level, from before the index dropped steeply in August. The gap to the Conference Board's consumer confidence index remains unusually elevated, as it usually is ahead of economic downturns. However, the gap narrowed substantially in Sept (and most likely in Oct too but CB has not reported
  - » The rebound in sentiment is chiefly due to an improved assessment of the current situation but expectations have recovered somewhat too
- CB's consumer confidence index fell more than expected in Sept, yet the level is far above avg
- Both surveys are above their long term averages and they do not signal a sudden halt in consumption. But…

SpareBank 1 MARKETS

Households' buying plans for large durables may be sending a warning sign

Buying conditions for durable goods usually well correlated to unemployment, with a 10 m lead

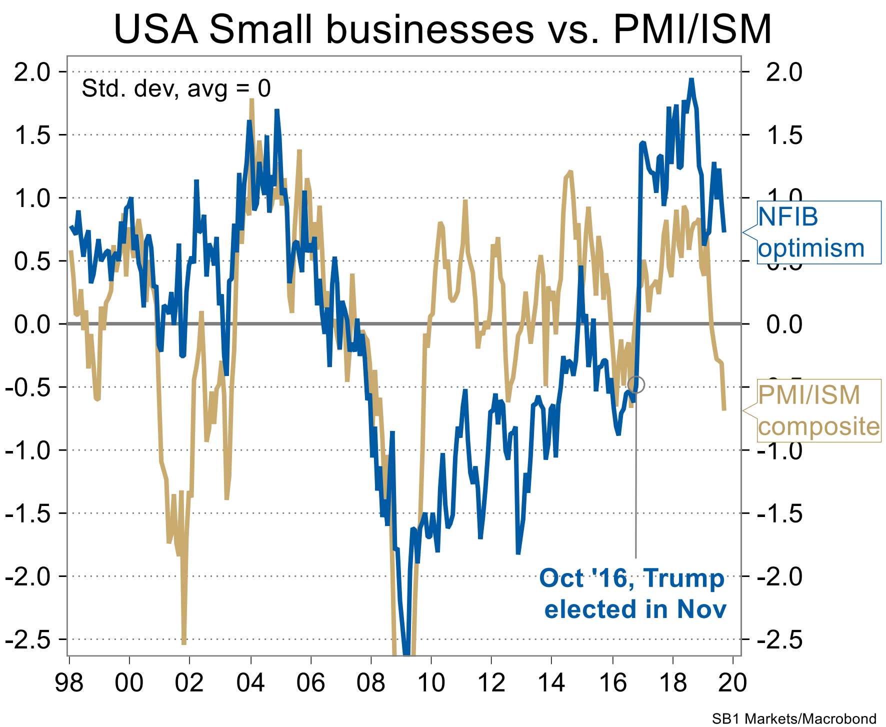


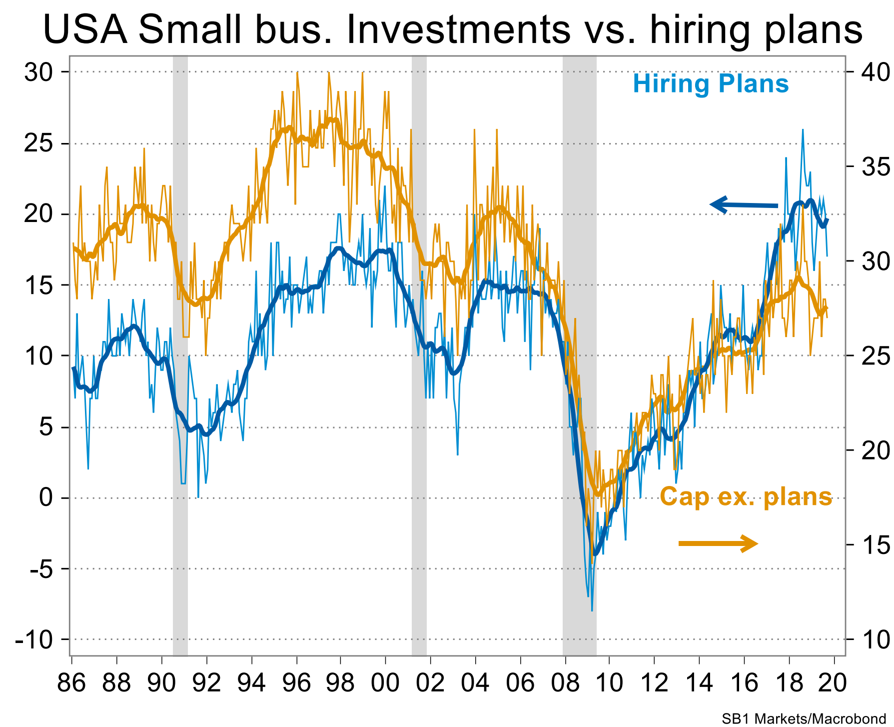


- The measure of buying conditions for large durable household goods has been weakening since mid-2018. This index is usually quite closely correlated to the unemployment rate, leading by 10-12 months. The chart above is surely not encouraging, although there have been some outliers before
  - » Note: The CCI buying conditions assessment is from August, thus, this might have improved along with the other indices. Still, the direction is no doubt downwards (and we have added a 6m smoothing at the chart above)
- The past 2 months, consumers' view of the current situations have improved substantially, to well above the July level. Consumer expectations remains rather soft, although edging up in Sept/Oct

Small businesses' optimism cools, still miles above PMI/ISM (activity)

NFIB optimism index is not weak – but cap ex, hiring, wage and price plans are lowered

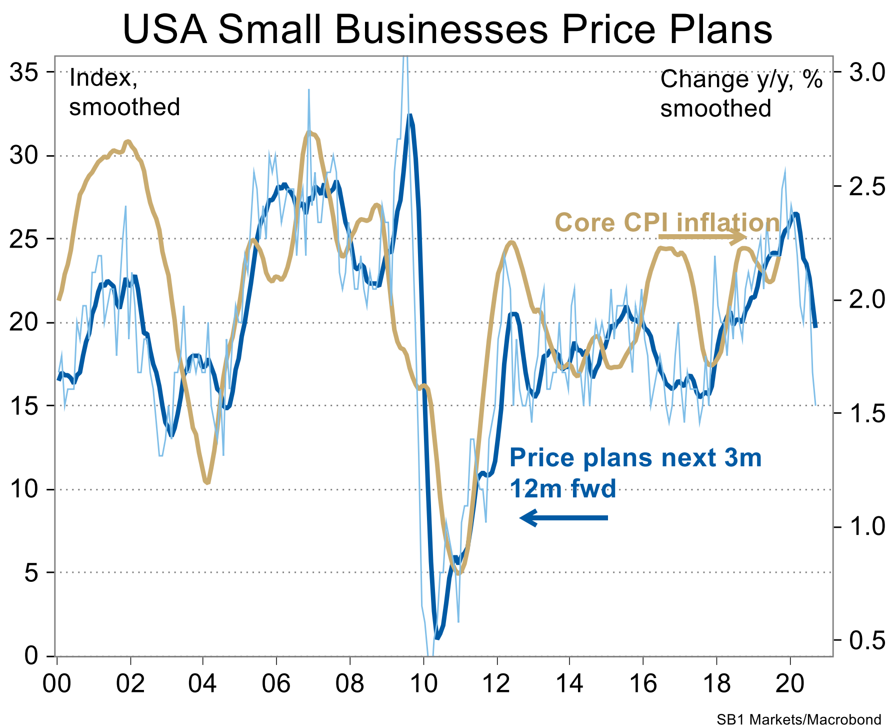


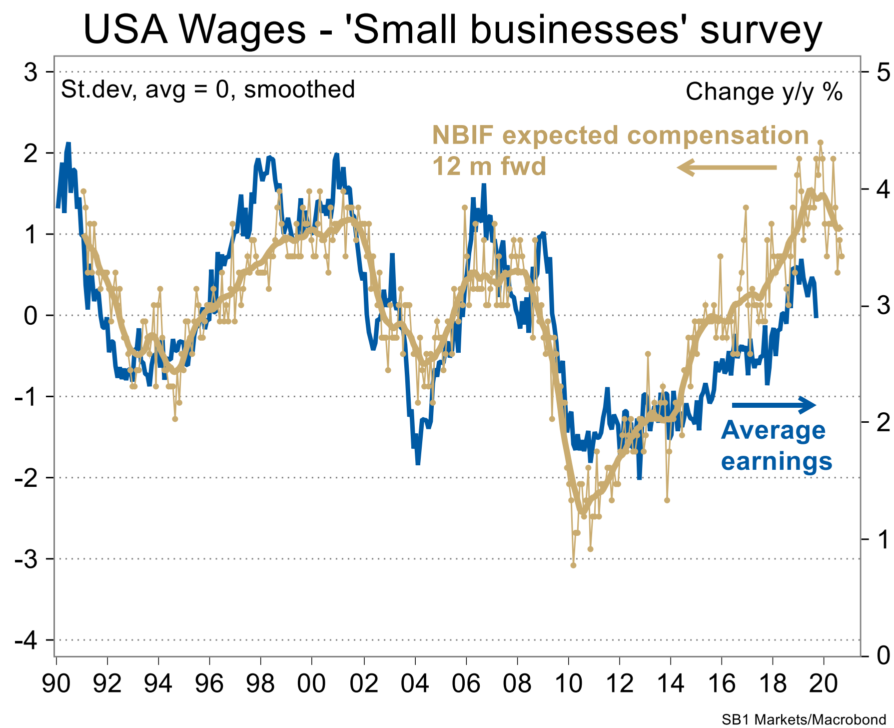


- The NFIB optimism index, measuring small businesses' expectations on business conditions, fell to 101.8 in September, slightly weaker than expected. Yet, the index has stabilised this year, still at a rather high level, after dropping in late 2018
  - » The NFIB optimism index is 0.7 st.dev above average. The surveys from ISM/Markit PMI (and most others) reports are well below average, signalling declining production below average levels. These different measures are not very closely correlated. The difference now may be due to the SME's exposure to the domestic market, while larger companies in the ISM/PMI are more influence by trade war uncertainties (export orders are plunging)
- Investment plans are slowly heading south, from a rather low level, compared to previous peaks
- Hiring plans har probably peaked but they are still aggressive. Companies are still not able to fill vacant positions

SMEs price plans are nudged down substantially, demand must be slowing

The index now suggests lower consumer inflation – and probably not higher wage inflation either?

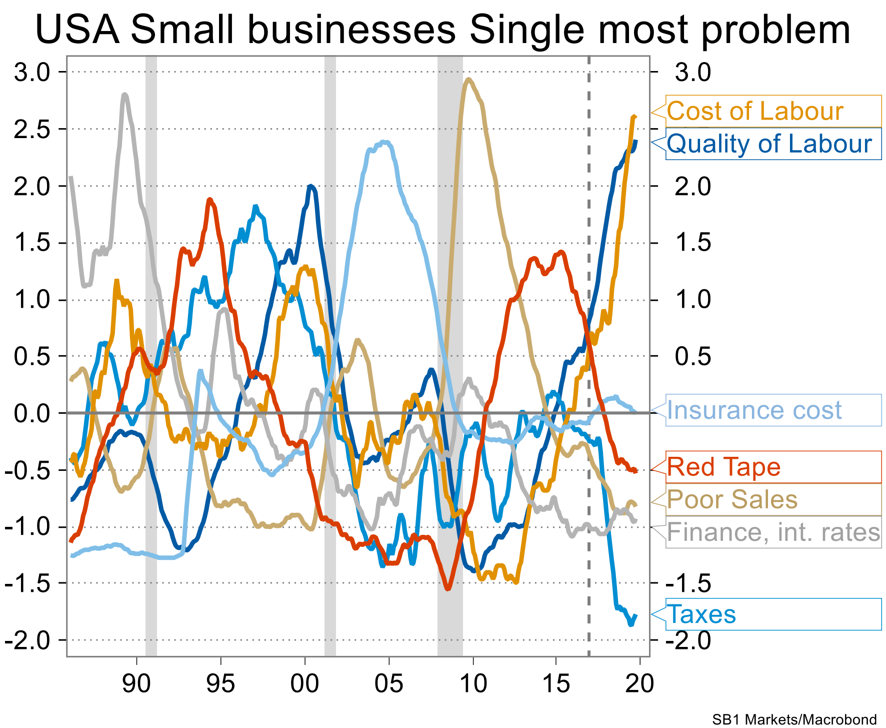


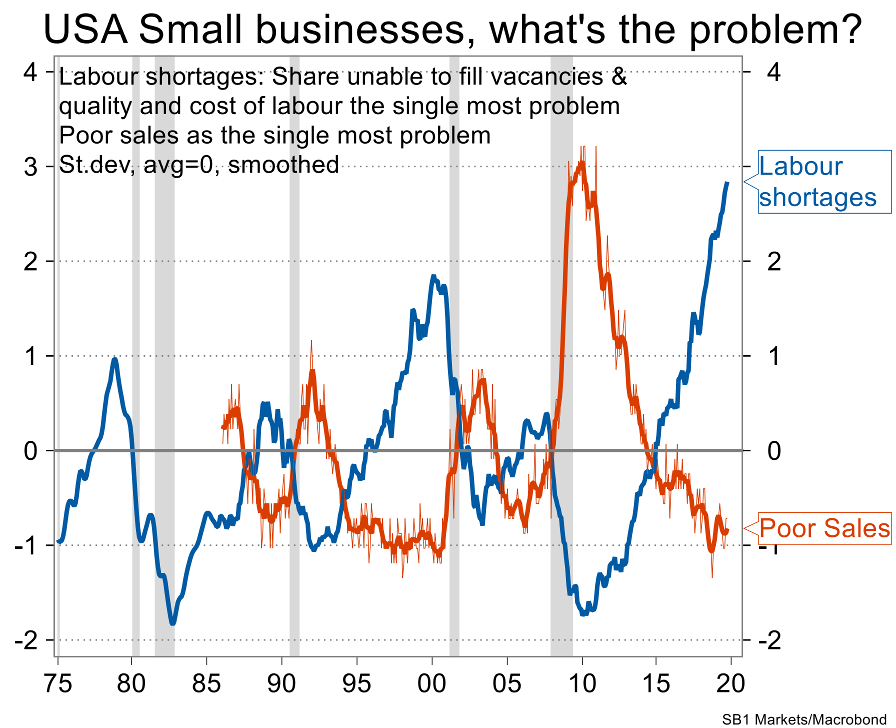


- Just 15% of small businesses are planning to hike prices in September, down from a peak at 29% in November last year. The smoothed share has fallen to 20%, from 26% at peak. Are companies witnessing a waning demand growth?
- Businesses are still reporting quite aggressive plans to raise compensation, but substantially less than some months ago. Actual wage growth has cooled somewhat, the survey does not signal any further slowdown - but probably not an acceleration either

What's the problem? Cost & quality of labour, not sales, interest rates or taxes

US SMEs have never before reported more problems due to cost and quality of labour!

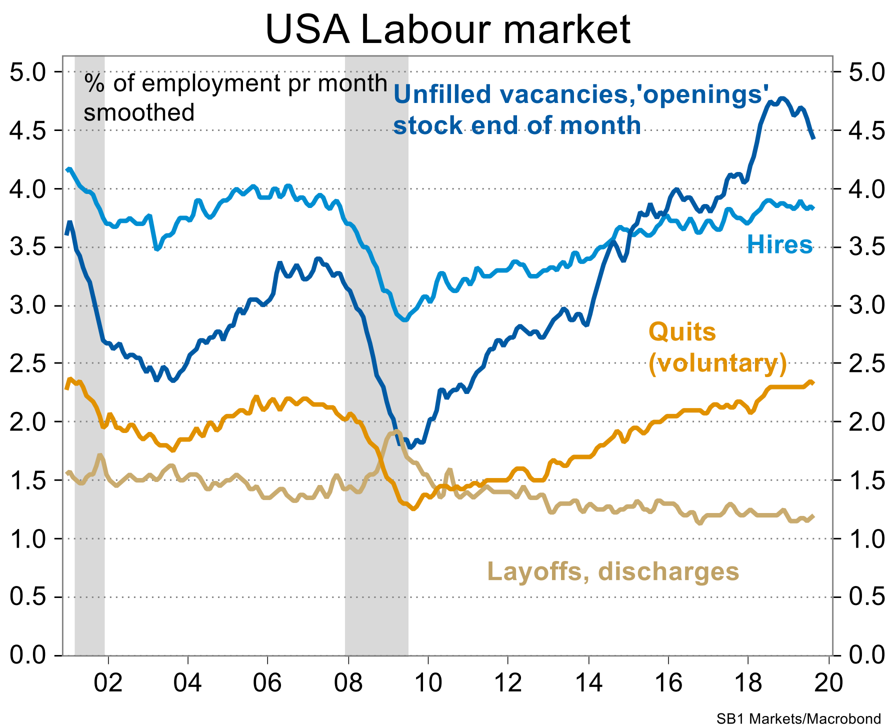


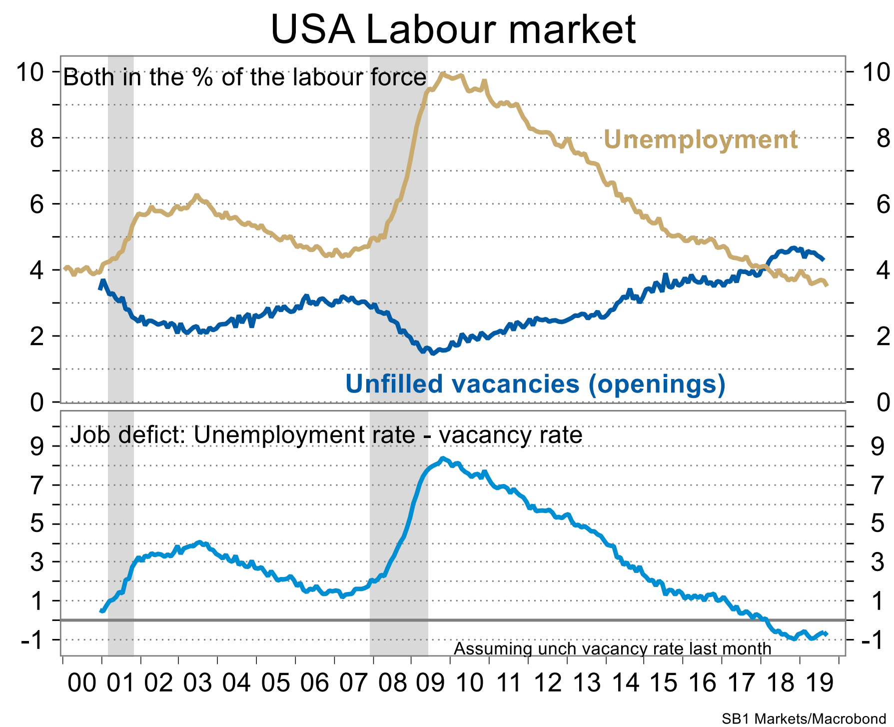


- And fewer than ever are complaining about finance/interest rates and about taxes, following last year's tax cuts
- Sales are not the problem either, almost 20 year since so few stated sales as the most important problem
- So the answer is obvious: The Fed must cut the fed fund to zero, or below, the USD must be taken down, as must taxes!
  - » Sure, at one stage in the economic cycle substantial interest rate cuts will be appropriate. It's just not now?

Unfilled vacancies down from peak, an early sign of a cooling labour market?

Still, a record number of people are leaving their job voluntary (to get a better) and layoffs are low

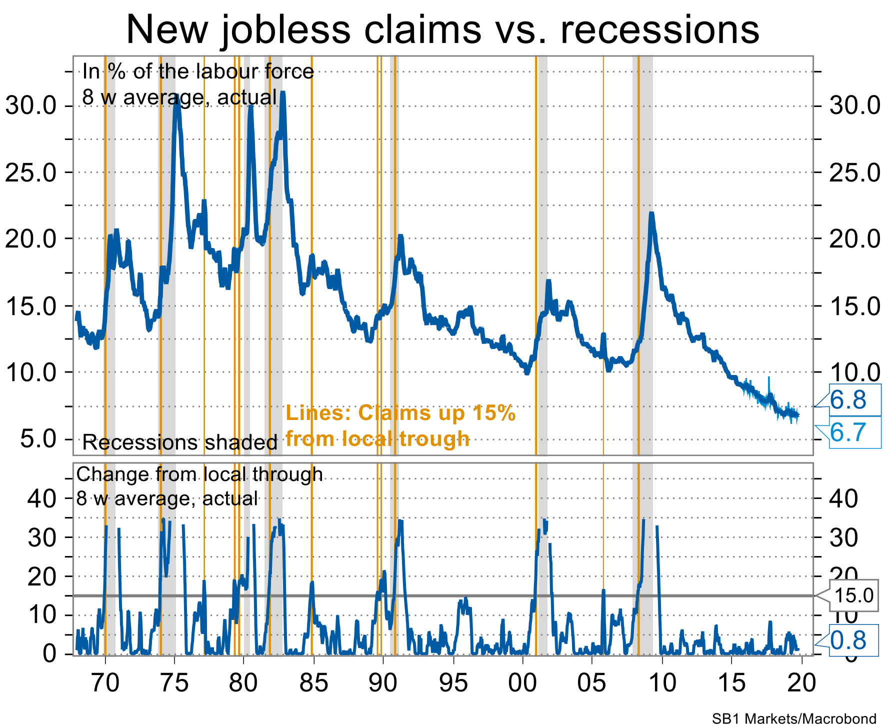


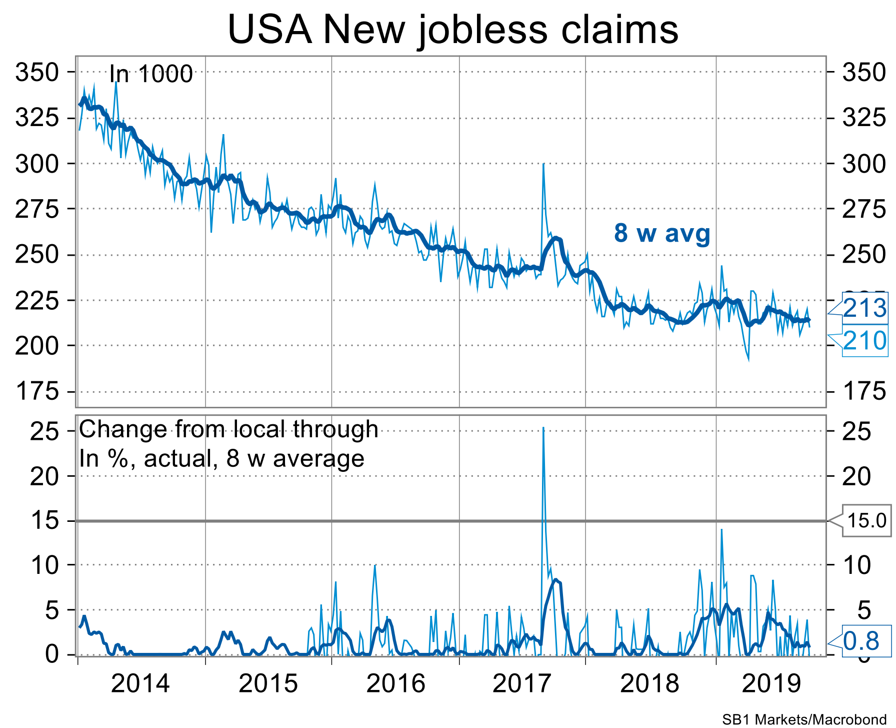


- The August JOLTS report suggests that the labour market may be starting to slowly cool off as the economy slows, job openings (unfilled vacancies) ticked down for the third straight month. The level remains elevated and the labour market is no doubt tight; there are still more unfilled jobs (4.3%) than unemployed people (3.5%). The gap is close to record high. Monthly (gross) hiring equals 3.8% (of total employment) and is not increasing anymore, most likely as businesses struggle to attract labour
- The number of voluntary quits is rising marginally, at a very high level – as many employees leave for better (paid) jobs
- Layoffs are trending down and is at very low level – but that's a lagging indicator

Jobless claims another tick down last week, no signs of weakness yet

Jobless claims fell to 210’ last week, the 8 w average is very low, at 213’

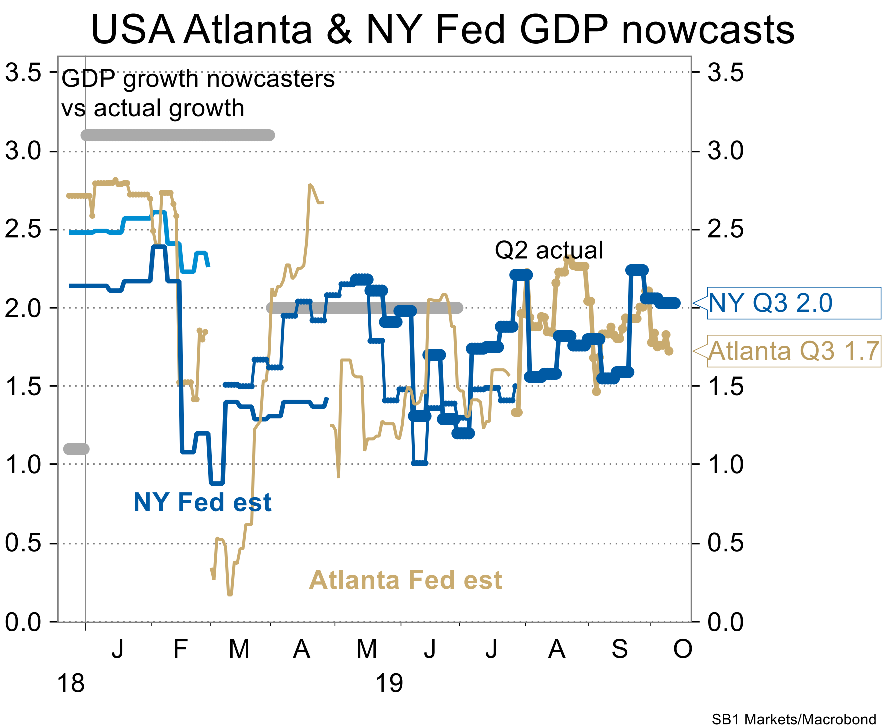


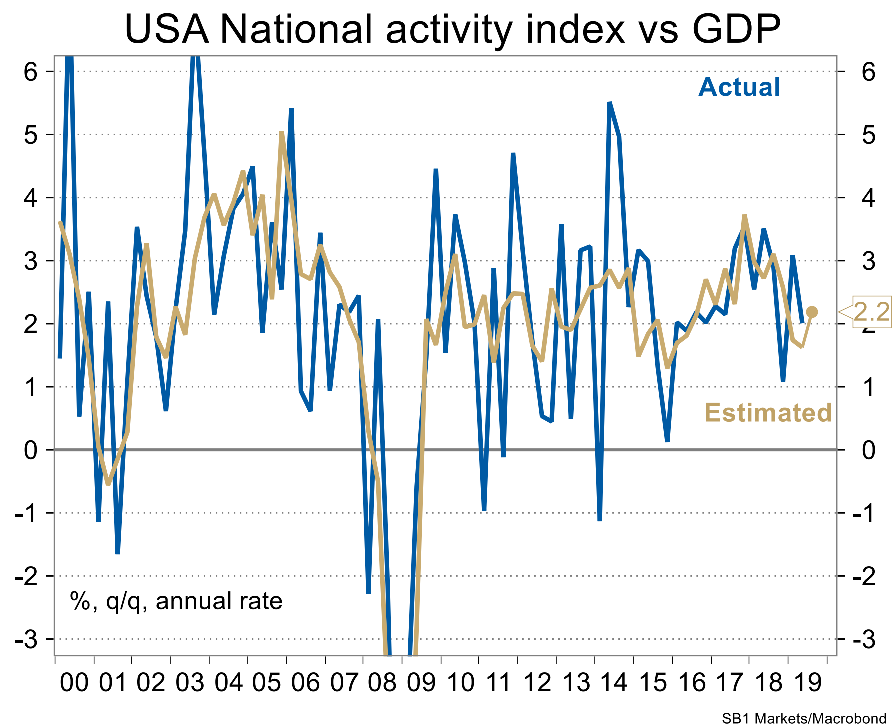


- A more than 15% increase in jobless claims (measured by the 8 week avg) is usually a good indication of a recession, and a yellow ‘recession’ warning line is to be drawn, check the chart to the left. So, no reason to worry now?

Nowcasters are signalling some 2% growth in Q3 as well

The nowcasters are noting 1.7-2% GDP growth in Q3, the National Activity index at 2.2%



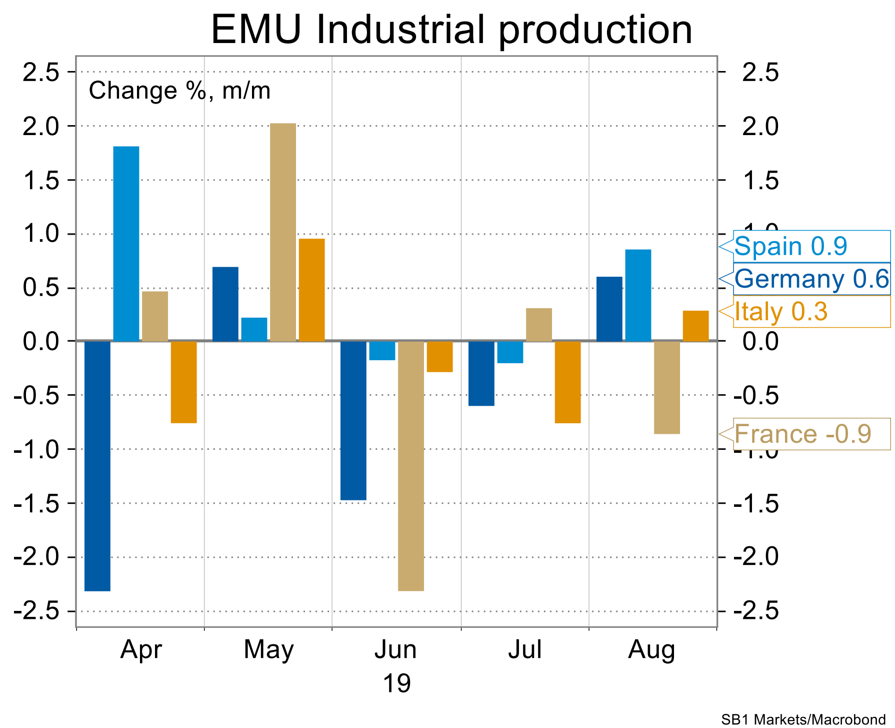


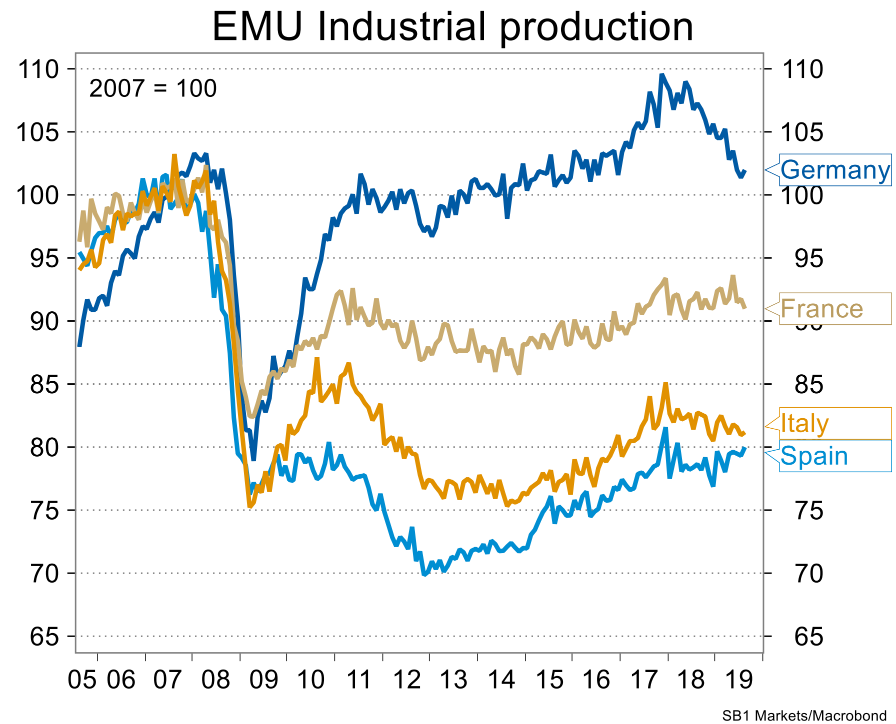
- The NY Feds weekly gauge fell to 2.0% two weeks ago, the ISM contributed. Atlanta Fed's model estimate fell to 1.7% last week, pulled down by weaker consumption data and surveys recent weeks. The index points to 2.2% GDP growth in Q3, from 1.6% last month (and 2.0% reported GDP growth in Q2)

SpareBank 1 MARKETS

Industrial production prob. recovered modestly in Aug but trend sharply down

Production in Germany and Spain improved, France further down. Germany still down 5% y/y

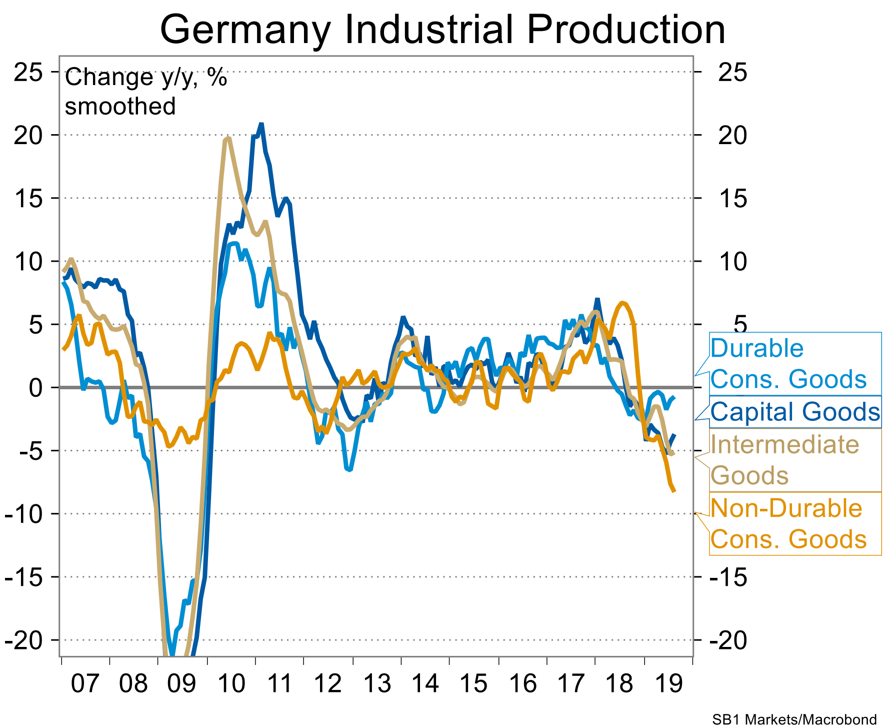


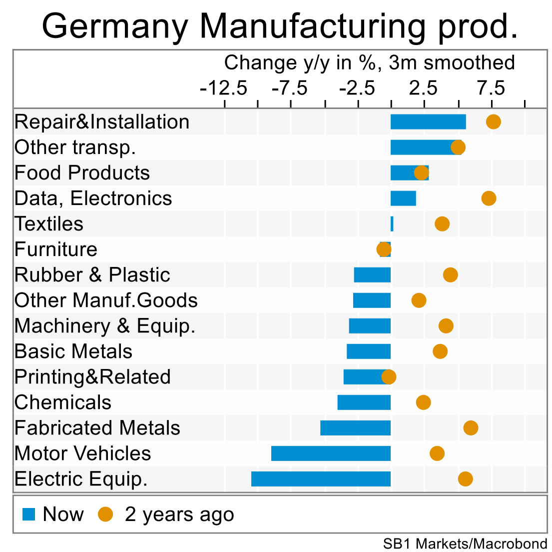


- We estimate a 0.3% m/m increase in EMU industrial production (ex construction) in August, just France weakened among the main countries; Spain up 0.9% and Germany up 0.6%
- However, the EMU industrial sector is no doubt struggling but almost only due to the problems in the Germany; France and Spain is just close to flat, Italy is trending down at 1% pace, while Germany is heading down by 5%. Such discrepancies are very unusual (Germany is not high 'beta') – and must be due to some peculiarities this time around, see more the following pages
- Production in the Euro zone was down 1.8% y/y in July, a 0.3% increase in Aug yields a 2.5% y/y decline. Q3 was no doubt weak. Unfortunately, the manufacturing PMI points to a deteriorating downturn

A broad German downswing, most manufacturing sectors are struggling

The slowdown is not just linked to the auto sector, 10 of 15 sectors are declining y/y

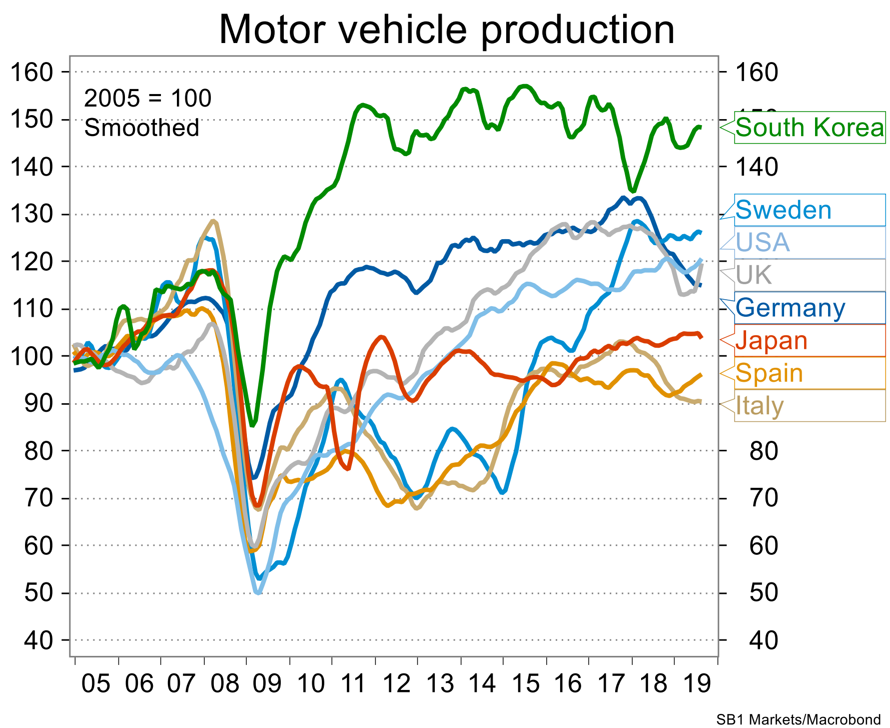


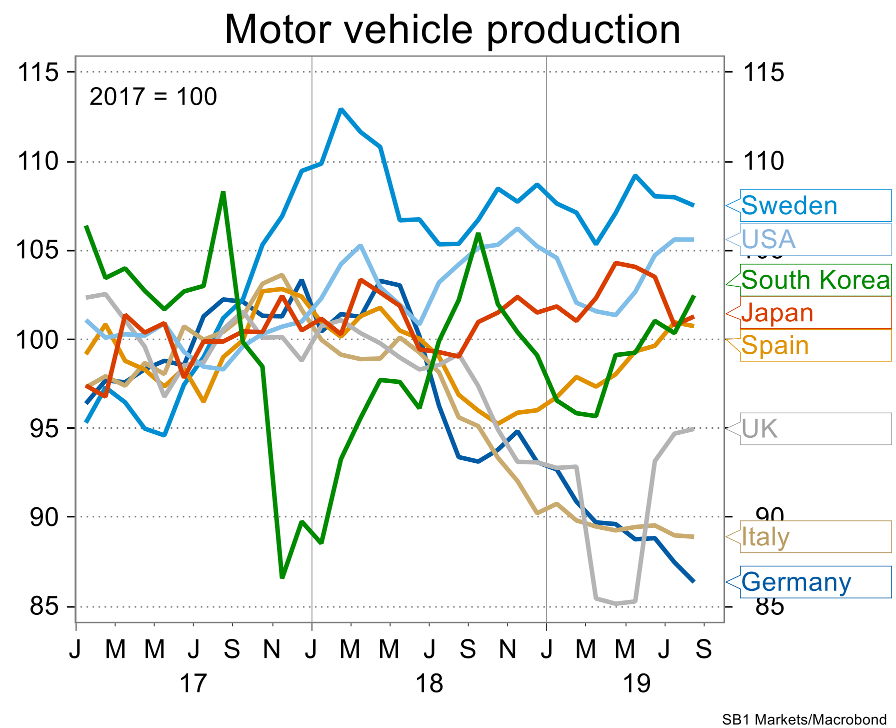


- Growth has slowed (or declined) in 13 of 15 sectors compared to 2 years ago. The dip in electric equipment may partly be spillovers from trouble in the auto industry, however, there must be a broader slowdown as well

No common auto production cycle, this time (as in 2007-10)

Germany the weakest link, but Italian production also sharply down

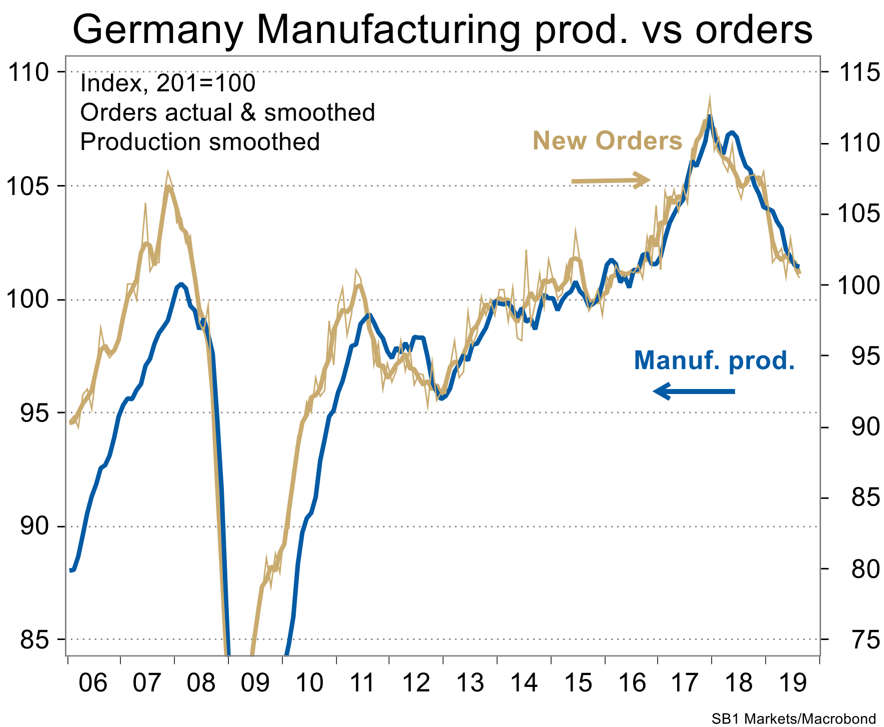


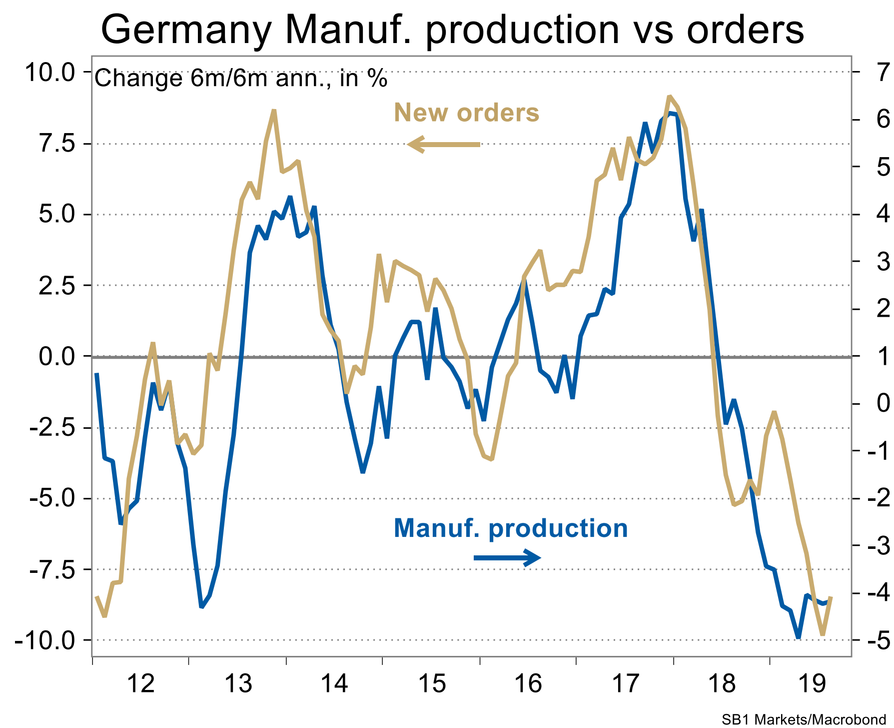


- UK down too, but has recovered over the summer
- Other countries have fared better the past quarters
- Over time, German producers have less to complain about?

Manufacturing orders do not point to any recovery in production

Orders are falling steeply and surveys are deteriorating, signalling a gloomy outlook

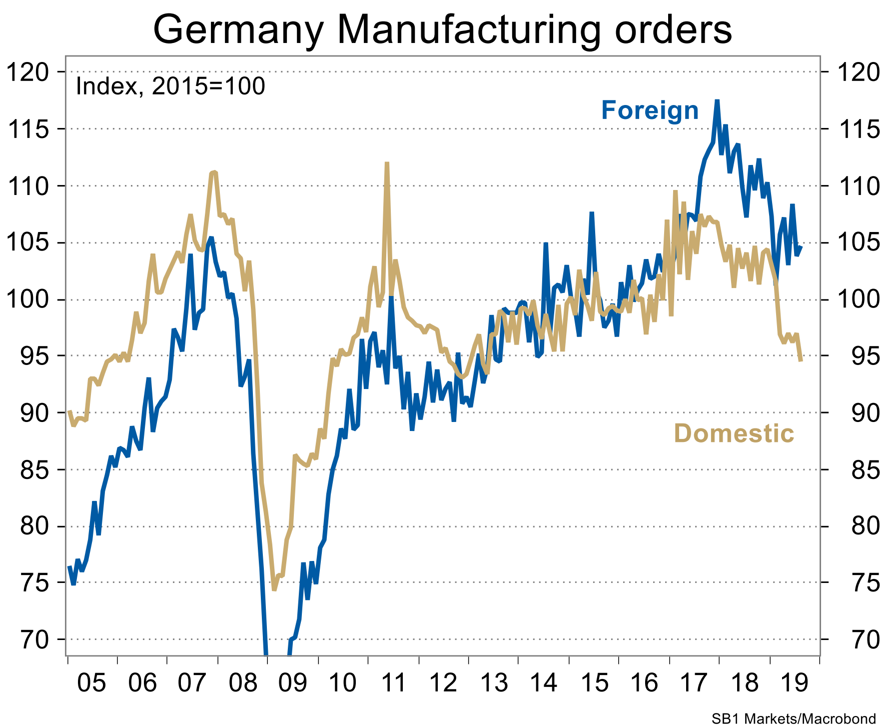


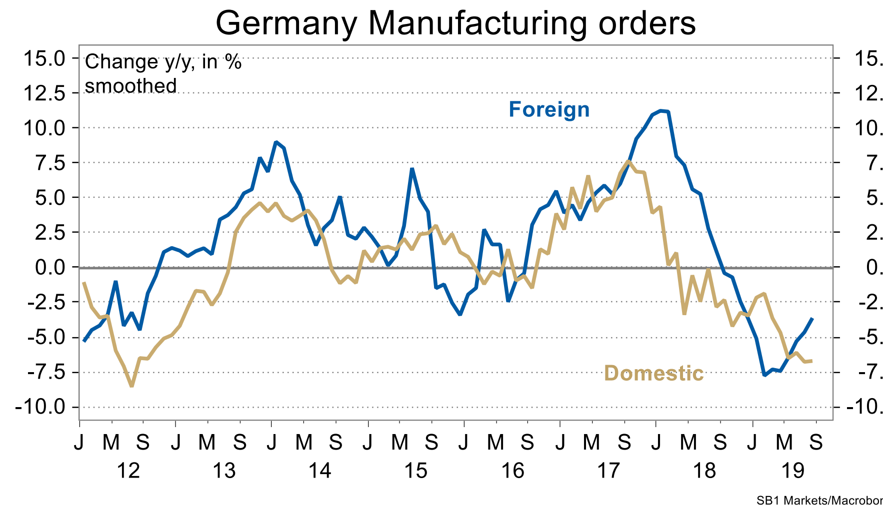


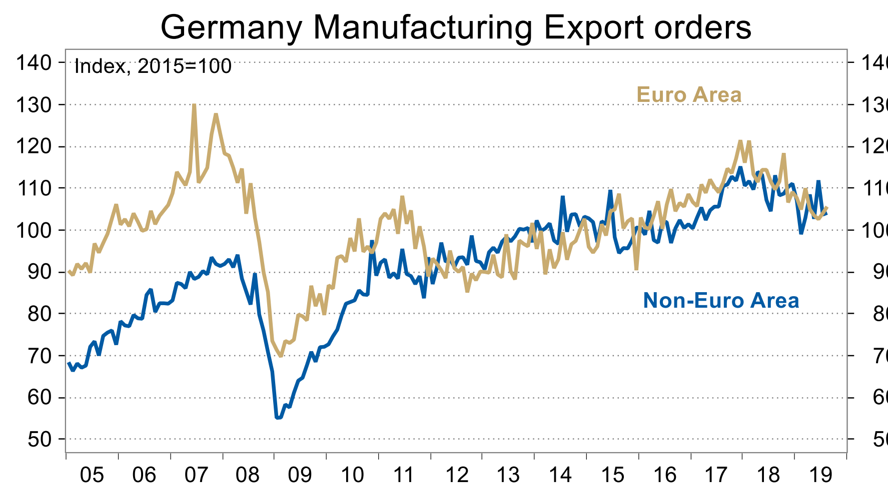
- Total manufacturing orders fell by 0.6% m/m in August and are no doubt trending steeply down. Orders are falling at the fastest pace since 2009, down 5% y/y (smoothed), although with some signs of stabilizing recent months
- Orders do not suggest any recovery in production from the 4.6% y/y decline in August
- The downturn recent months is primarily driven by weaker domestic demand, while foreign orders fell rapidly in 2018. Weaker domestic demand may just be a reflection of a mature German growth cycle, challenging adjustments to new auto emission standards but is probably also influenced by uncertainties regarding the future global trade regime (both vs the US and UK)

Domestic orders are slipping, foreign orders stabilized

Orders from within Germany are plummeting, while export orders have improved slightly recently



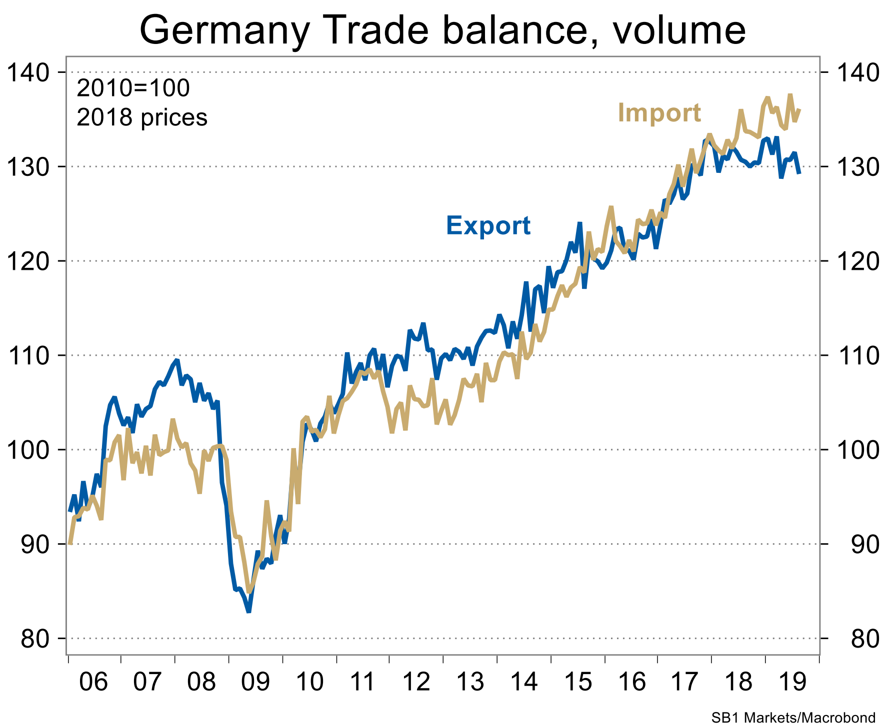


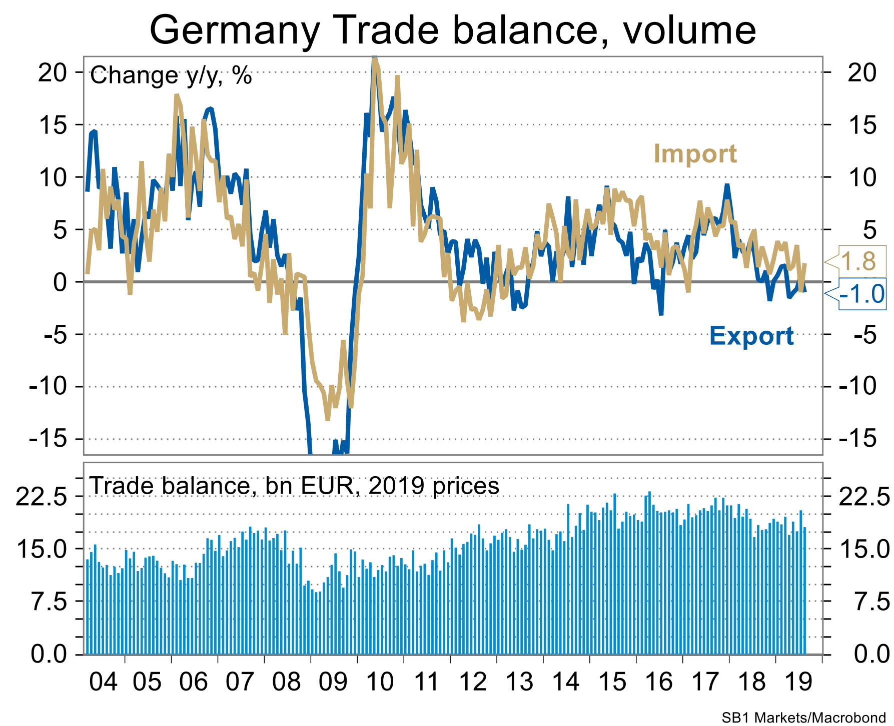


- Export orders from both non-EU countries and within EU slowed in 2018, stabilizing recent months
- On domestic orders, check the previous page

Exports are declining but just softly, imports are stalling

Exports do not explain all of the weakness in German manufacturing. And imports are not that weak

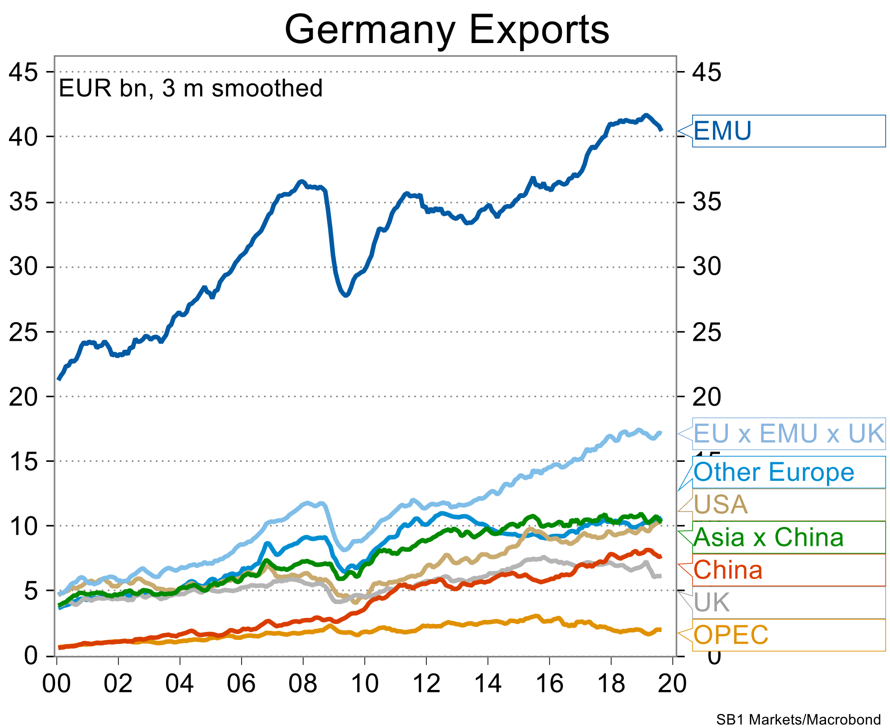


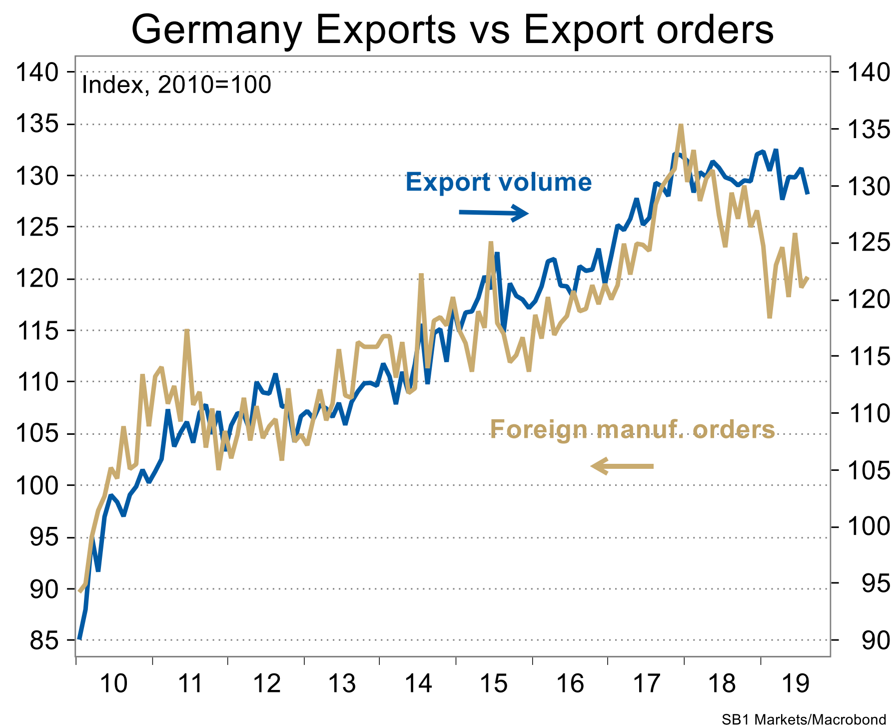


- Export volumes dropped 1.8% m/ in August and are trending slightly down. However, the annual rate is down by just 1% and exports have hold up much better export orders. Manufacturing production has fallen more than exports. However, that's normal, manufacturing production is just a tad weaker than normal vs. exports (see two pages forward)
  - » Regional developments, see next page
- Import volumes rose 1% m/m in August and the annual rate is still up 1.8%. Imports have flattened out the past 4-5 months
- The German trade surplus is slowly shrinking, now equalling approx. 6% of GDP, from 8% in 2016

Exports have slowed in several directions, US still heading up

Foreign orders indicate weaker total exports, as do PMIs and other surveys





- Most likely, exports are weakening due to a global retreat in business investments, triggered by trade war/Brexit uncertainties and probably also a 'normal' mature cycle
  - » Exports to China have slowed the past months and are down 1.2% y/y (data until July), vs above 8% growth in April
  - » Exports to UK have fallen rapidly since the spring, as businesses there have been cutting back purchases after a huge stockpiling ahead of the prior Brexit deadline. Exports to the US is still trending up. Exports to other EMU partners have slowed, as have exports to other EU countries
  - » Germany's main export markets: The other EMU countries (37%), other EU countries x UK (15%), Asia x China (10%), Europe x EU (10%), USA (9%), China (7%), UK (6%)

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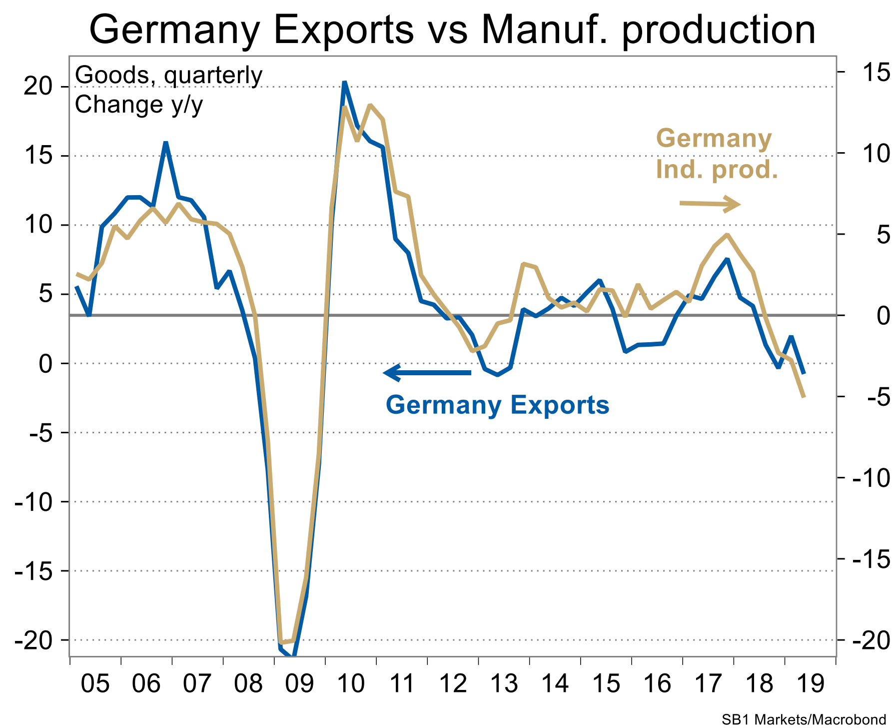
Guess what, German foreign trade is closely correlated to…

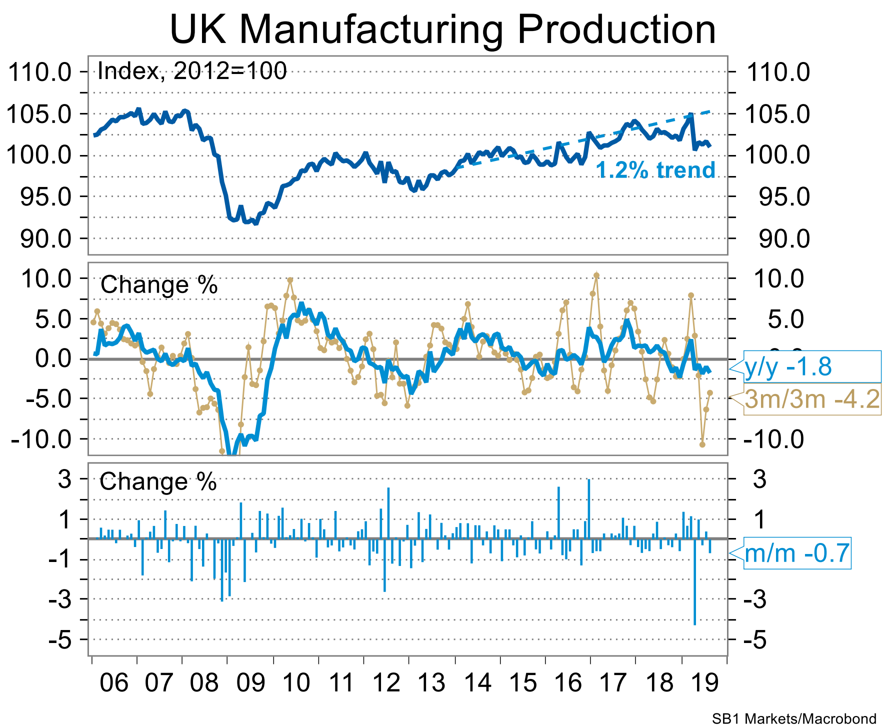
.. global trade. Now, both have stagnated due to trade war/Brexit uncertainties, and a mature cycle

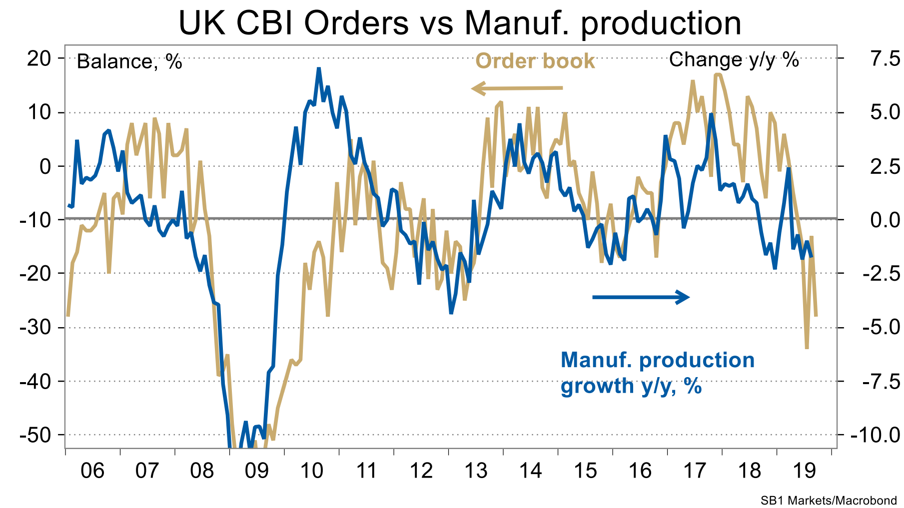


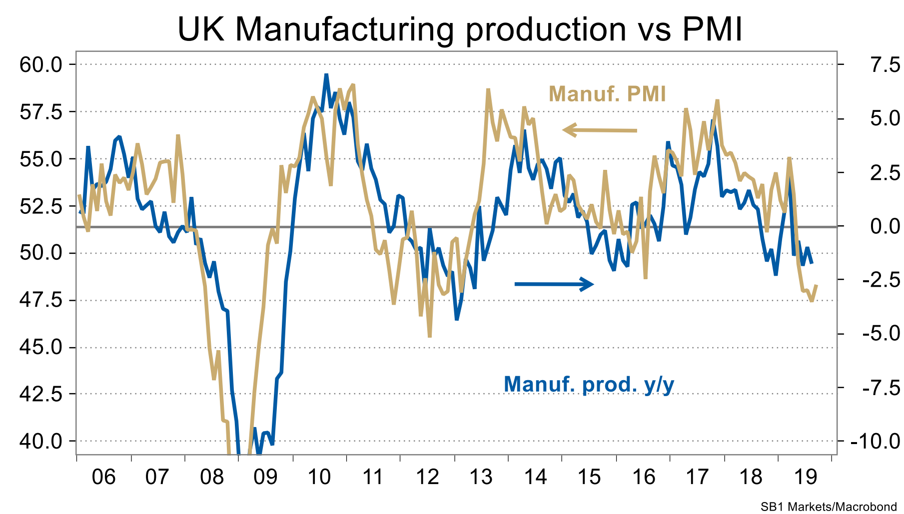
- Both German foreign trade (and thus lobal trade) is highly correlated to German industrial production, though with production growing at a slower pace. In addition, production is a tad more volatile than exports.
  - In sum, the current decline in production is not that far below 'normal', given the modest decline in exports.
- The reason is that domestic demand weakens in line with global demand (or some inventories are emptied or imports have taken a larger market share). Given signals from PMIs/other surveys, a near term production recovery is not likely

Manufacturing production remains sluggish, still more downside risk?

Production fell 0.7% m/m in Aug, annual growth down 1.8%. PMI, orders signal a steeper decline





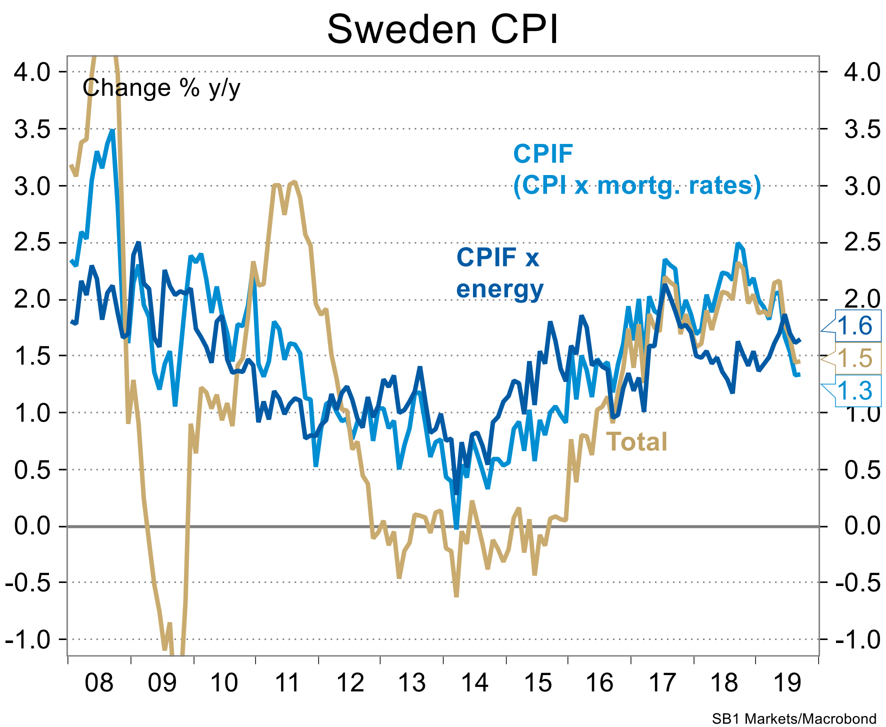


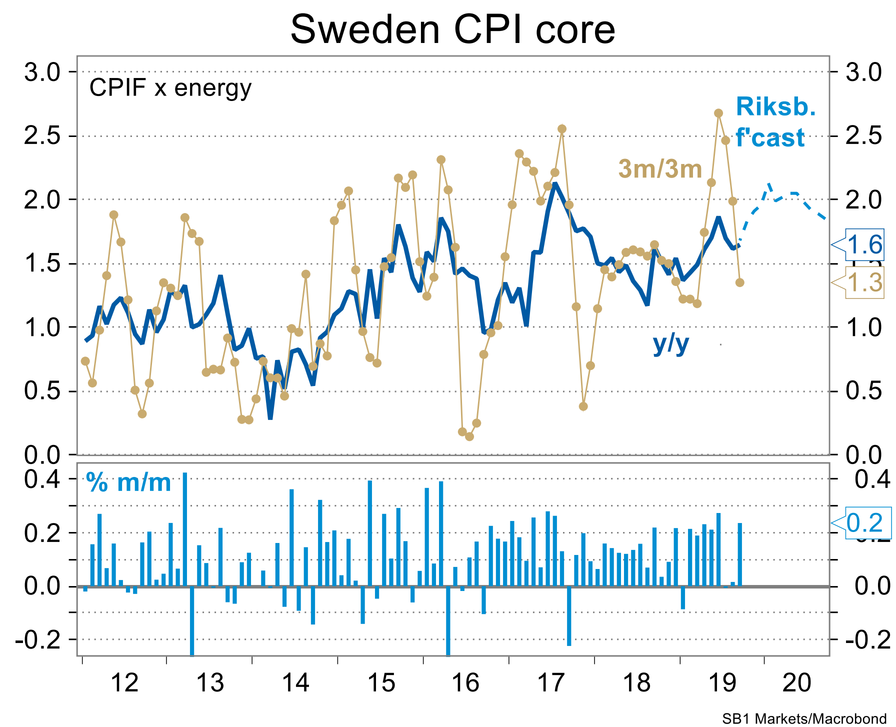
- Production was 'artificially' high in March 2019, before the previously assumed Brexit date, March 30. Inventories were built sharply up before the deadline, and this effect was later put in reverse. Inventories are being trimmed and orders are now being cut
- All activity surveys have turned south recently, the production outlook is rather bleak

SpareBank 1 MARKETS

Core inflation steady in September, the Riksbank f'casts an acceleration

Core CPIF was unchanged at 1.6%, 0.1 pp above expectations. Underlying growth modest at 1.3%

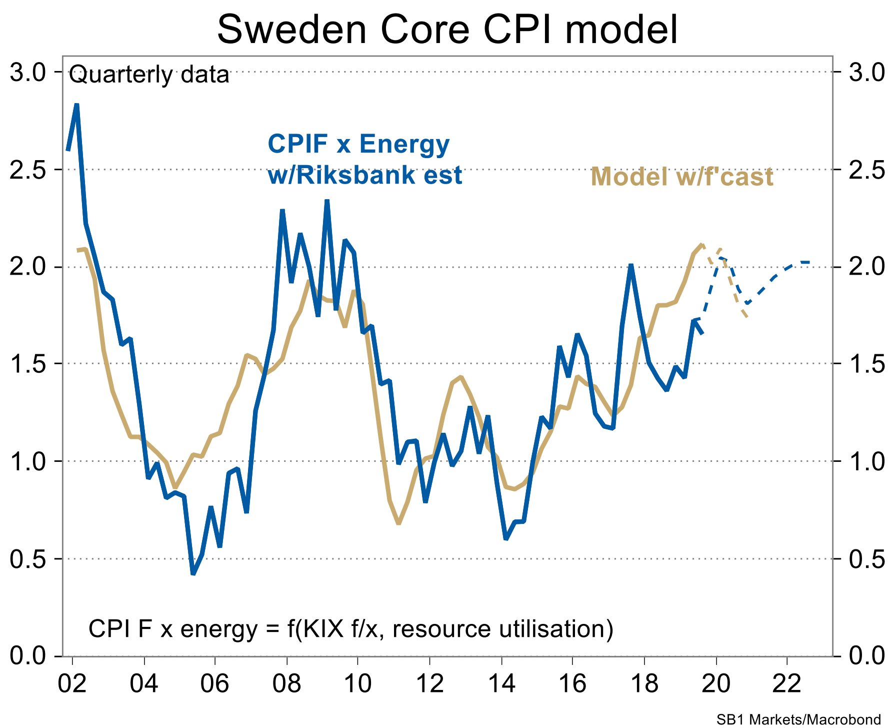


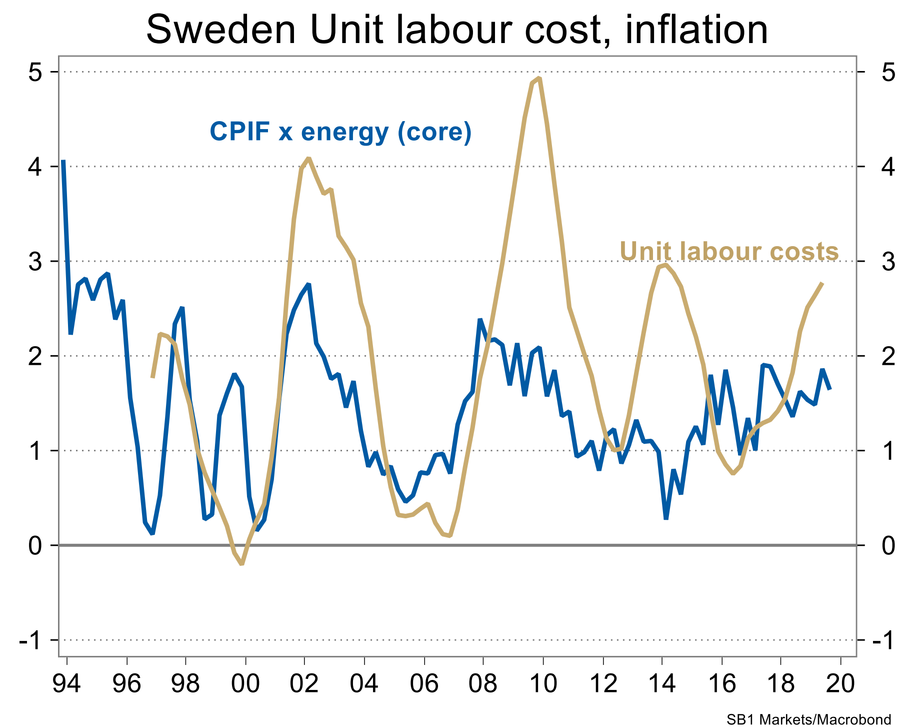


- The 'real' core (CPIF ex energy) increased by 0.2% m/m in September. The annual rate held steady at 1.6%, 0.1 pp above consensus f'casts, and 0.1 pp below the Riksbank's projection. Core inflation has slowed somewhat this autumn, and underlying growth is lower than the annual rate
  - » CPIF (ex mortgage rates) was flat at 1.3% y/y – dragged down by lower energy prices recently
  - » Our simple inflation model signals above 2% core inflation but a slowdown going forward
- At the September meeting, the Riksbank surprised markets by sticking to its plans to hike interest rates in Q4 or Q1. Core inflation below the 2% price target is not a strong argument for lifting rates (neither is the labour market)

Our model says inflation is peaking now (at a much higher level)

Softening capacity utilisation does not indicate higher inflation but the SEK and unit labour costs do

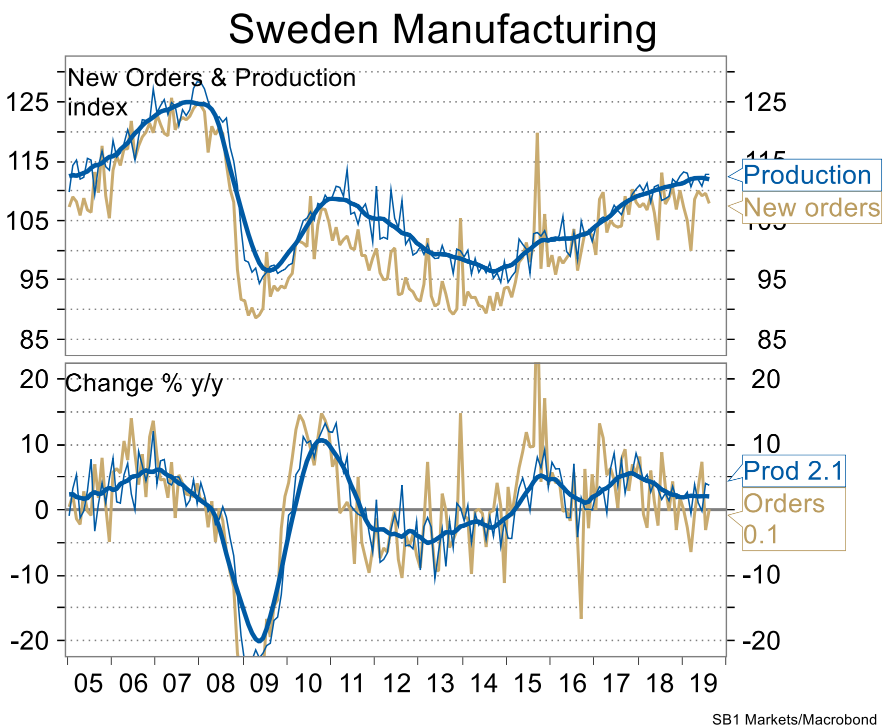


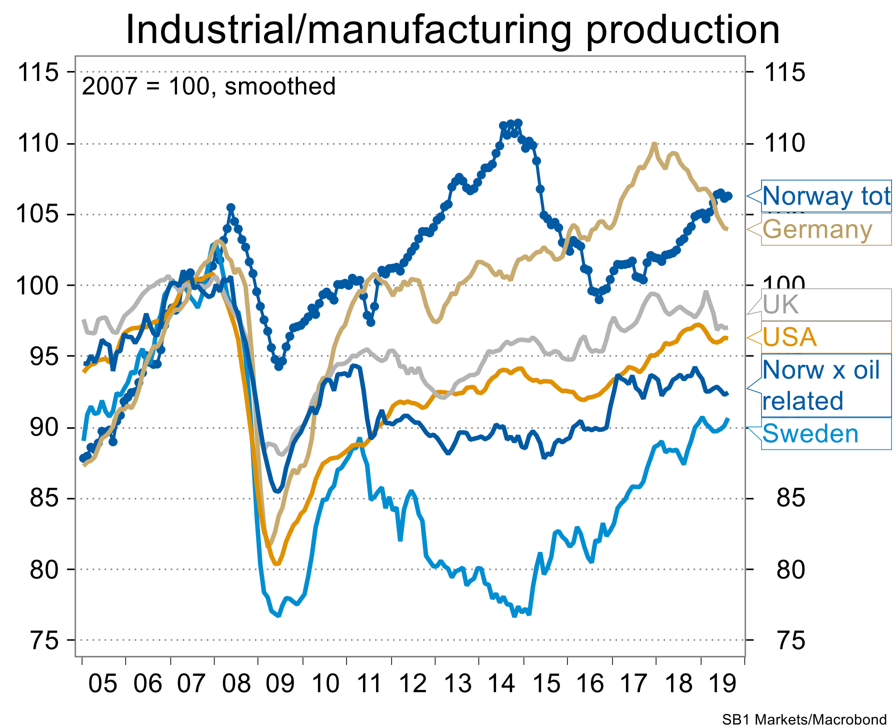


- Our model includes SEK and the Riksbank's Resource Utilisation indicator, measuring deviation from potential GDP growth. The RU indictor has weakened this year, although capacity utilisation is still higher than normal. The inflation model points higher inflation now, at 2.1%, vs Q3 growth at 1.7%, before easing next year
- On the other hand, productivity has disappeared, it fell 0.1% y/y in Q2 and unit labour costs were up 2.8% y/y. Hence, the cost pressure is not low at all!
- The Riksbank expects inflation to accelerate the coming months and peak at 2% in early 2020

Manufacturing production (and orders almost) still OK

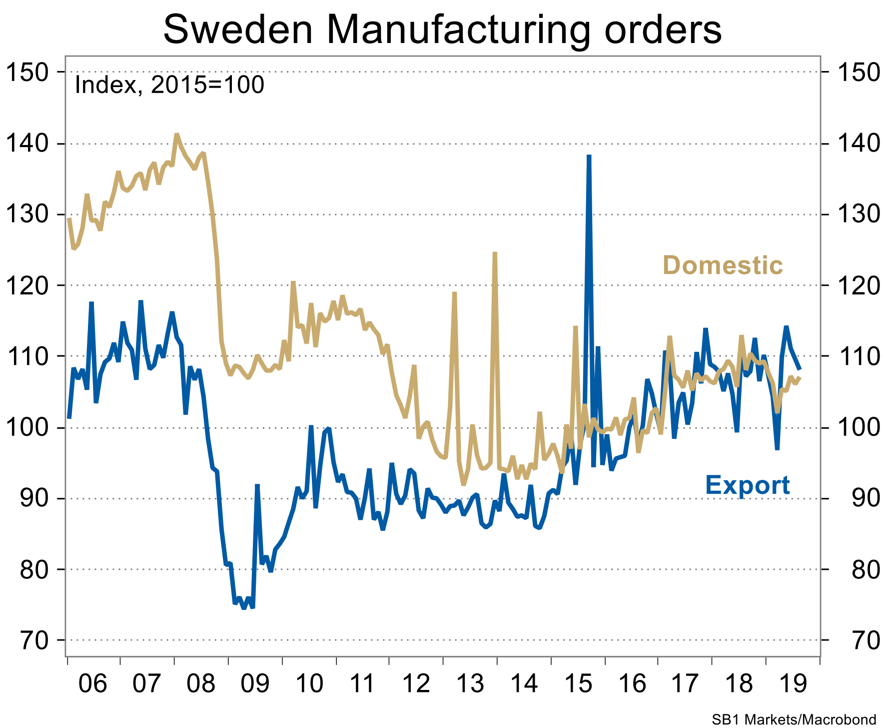
Production down 1% in August but trend is still marginally up. Orders just a tad weaker

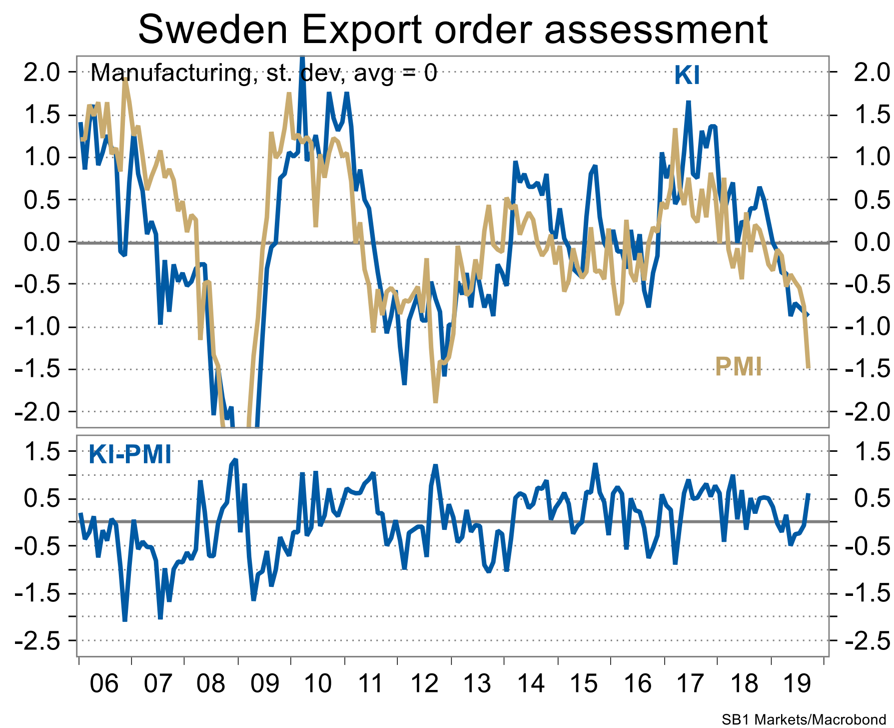




Manufacturing orders almost OK, exports orders not weak. But surveys…

Exports orders down in Aug, but is back at normal level. Surveys signal a sharp setback

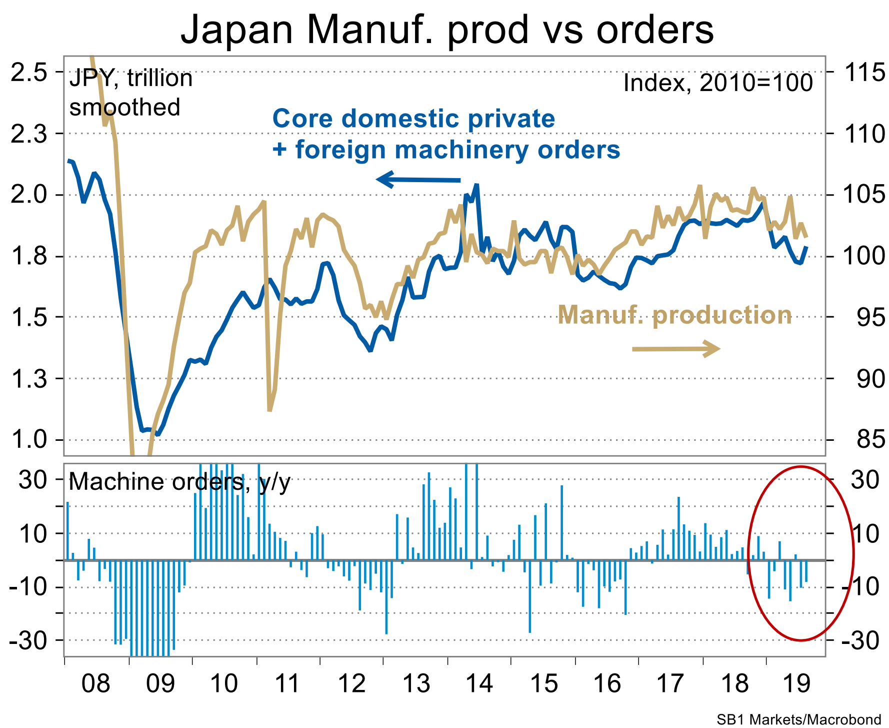


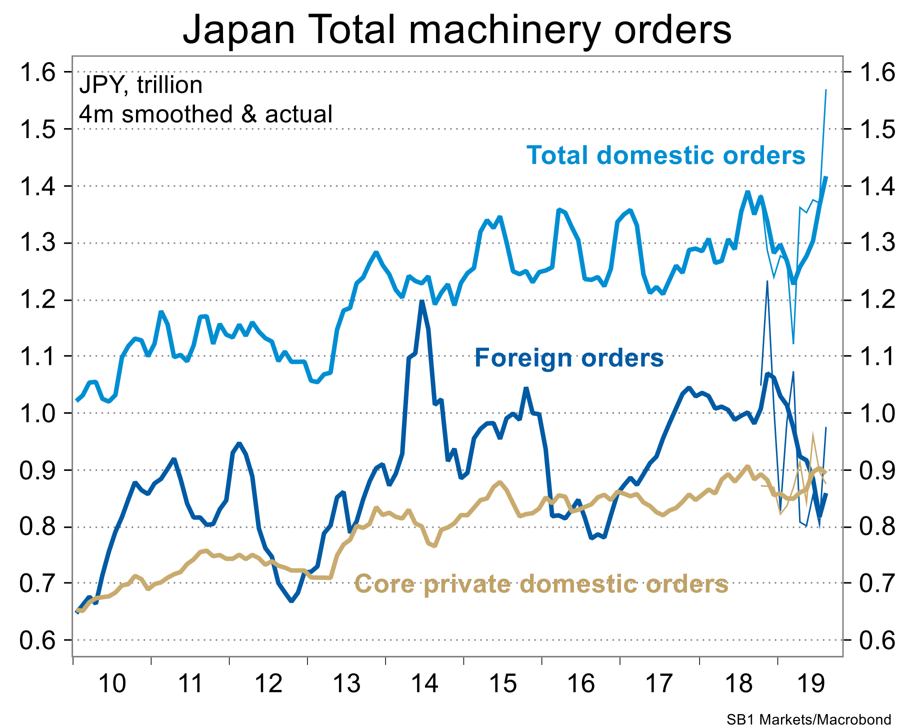


- Domestic orders have recovered from the March local trough but remains below the 2018 (local) peak

Core machine orders are heading up, thanks to domestic demand

The drop in the annual rate is just noise, machine orders have been improving recent months



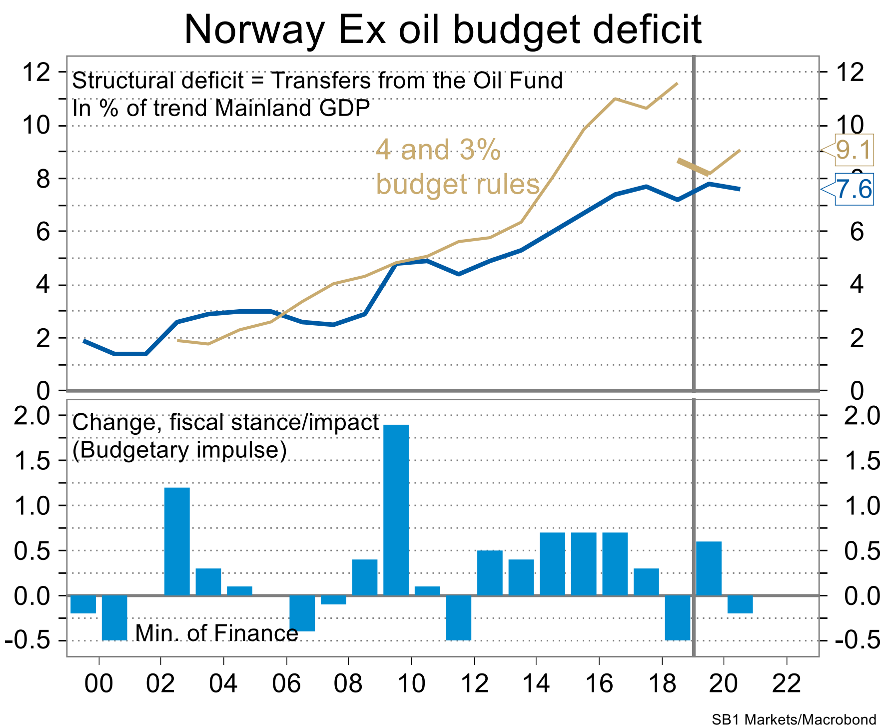


- Core private domestic machinery orders fell marginally in August. Orders have picked up the past 4-5 months and underlying growth, measured 3m/3m annualized, is up 17% (these are very volatile figures). Regardless, media reports a steep decline, as the annual rate fell 10% (or 15% not seasonally/working days adjusted). This figure is useless, the y/y drop is just due to a spike in August last year, which was followed by a steep decline, and the annual rate will plunge in September. Our 3m smoothed annual rate is +1% (domestic orders)
- Industrial production is anyway better correlated with orders including foreign order – which BTW has fallen sharply. Total domestic orders have soared but is not correlated to industrial production
- Manufacturing production is down 1.8% y/y, as signalled by domestic private + foreign orders. In addition, the PMI manufacturing order index at 47.5 points to declining orders & production

- Highlights
- The world around us
- **The Norwegian economy**
- Market charts & comments

A tighter 2020 budget than expected (and not just on the paper)

A budget impulse at -0.2%, and expenditure growth was lower than we expected



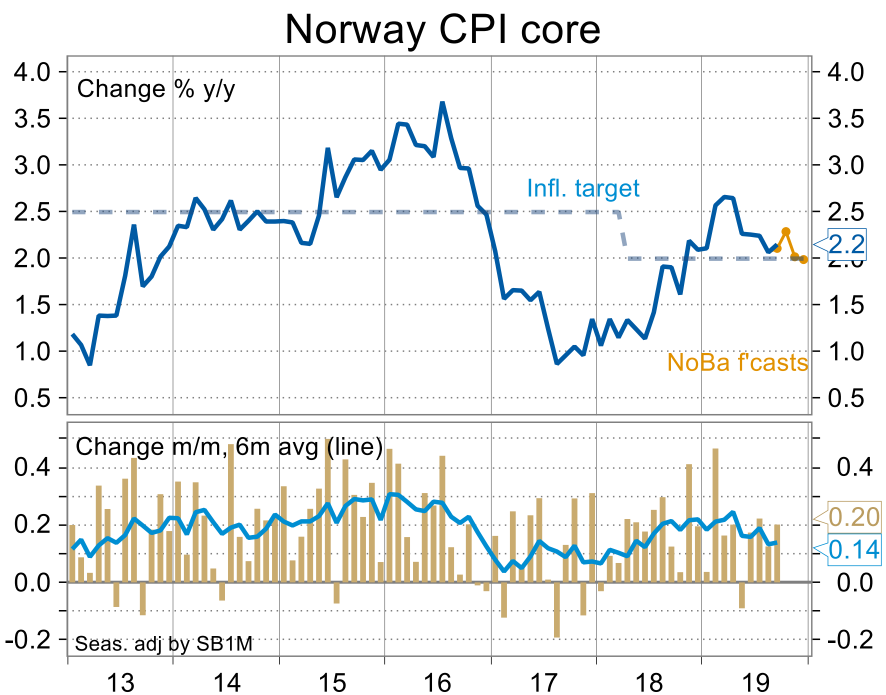
Fiscal indicators NOK bn, per cent	**2018**	**2019**	**2020**	SB1 est **2020**
Actual surplus, incl. oil	*250*	*234*	*246*	*189*
Surplus ex. oil	*-219*	*-233*	*-241*	*-237*
Structural surplus ex oil	***-214***	***-239***	***-244***	***-249***
.... change in bn	*0*	*-25*	*-5*	*-14*
.. in % of GDP	*-7.2*	*-7.8*	*-7.6*	*-7.8*
... Change (fiscal indicator)	***-0.1***	***-0.6***	***0.2***	***-0.2***
.. in % of Oil Fund value	*2.5*	*2.7*	*2.6*	*2.6*
Spending rule, bn.	*-255*	*-261*	*-285*	*-292*
Deviation from rule, bn.	*41*	*22*	*41*	*43*
Real growth in underlying spending	*1.7*	*2.0*	*0.8*	*1.8*
Petroleum Fund, bn, ult.	*8243*	*9500*	*9985*	*10183*

Min of Finance, Sparebank 1 Markets

- The government certainly 'passed the test', following an expansionary 2019 budget. The 2020 structural nonoil deficit was raised to NOK 244 bn, slightly less than we expected. Hence, the fiscal indicator equals -0.2%, from +0.6% in 2019.
  - » 0.1 pp of the tightening is due to transitory revenues from sales of climate quotas (which will weaken the budget next year by almost 0.3 pp). We expected a +0.2% impulse net of these quotas, so the budget was 0.3 pp tighter than we expected. In the table above, the indicator is measured as change in the surplus, not deficit
  - » Underlying growth in expenditure is estimated to 0.8%, we expected +1.8%.
- The 2020 nonoil deficit (=transfers from the Fund) equals 2.6% of the Fund's value, well below the spending rule at 3% (by NOK 41 bn). Nobody reckons 3% to be appropriate now, given growth in the Fund value and the upswing in the Norwegian economy

Core inflation edged up to 2.2% in Sept, total inflation eased to 1.5%

Core CPI inflation has been cooling since the spring but remains above the price target



SB1 Markets/Macrobond

- CPI-ATE (ex. energy and taxes) rose 0.1 pp to 2.2% y/y in Sept, we and consensus expected an unchanged pace of inflation. In the Sept MPR, Norges Bank's nudged down the inflation f'cast to a 2.1% speed in Sept (and 2.3% for 2019)
  - » CPI-ATE rose 0.2% m/m (seas adj), slightly above the 6 m average
  - » Accelerating prices on airline tickets and furniture & household equipment boosted monthly inflation. Core y/y inflation excl. the volatile airline tickets equals 1.9%
  - » Imported goods are up just 1.2% y/y, and we do not expect much more, even with the weak NOK. Domestic goods & serv. up 2.6%, due to wage inflation above 3%, slow productivity growth and capacity to increase prices are demand is not weak
- Total CPI growth fell marginally to 1.5%, as expected. Total inflation has been pushed down by a steep decline in electricity prices. Good for real income growth, and for consumption!
- **Implications**
  - » Core inflation remains just above the price target and September was close to NoBa's f'cast
  - » No substantial market reaction, NOK strengthened marginally just after the report

SpareBank 1 MARKETS

No big outliers in Sept, furnishing and airline tickets surprised on the upside

Core CPI prices rose 0.2% m/m, in line with our f'cast, annual inflation 0.1 pp above

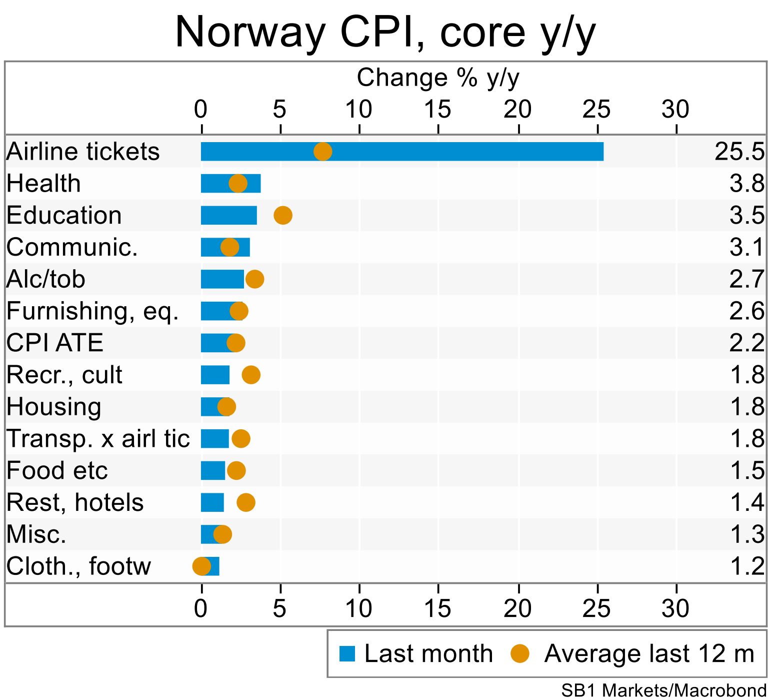
		Change m/m, seas. adj			Change y/y			Contribution, pp		
Sep-19	Weight	Out-	SB1M	Dev.	Last	Out-	SB1M			Dev. vs
CPI ATE	%	come	f'cast	pp	month	come	f'cast	m/m	y/y	f'cast
Food, non alc bev	12.5	0.1	0.2	-0.1	1.6	1.5	1.8	0.01	0.19	-0.02
Alcohol, tobacco	3.9	0.3	0.2	0.1	2.6	2.7	2.5	0.01	0.11	0.01
Clothing, footwear	4.9	0.2	-0.2	0.4	-0.6	1.2	0.6	0.01	0.06	0.02
Housing x. energy	20.1	0.2	0.2	0.0	1.8	1.8	1.7	0.04	0.36	0.01
Furnishing	6.6	1.3	0.2	1.1	1.8	2.6	1.2	0.08	0.17	0.07
Health	3.2	-0.0	0.2	-0.2	4.0	3.8	4.0	-0.00	0.12	-0.01
Transp. ex. gas, airl. tick	12.0	-0.1	0.2	-0.2	2.4	2.0	2.4	-0.01	0.24	-0.03
Airline tickets	1.2	5.2	0.2	5.0	14.0	25.5	16.4	0.06	0.29	0.06
Communication	2.2	-0.5	0.1	-0.6	3.6	3.1	3.6	-0.01	0.07	-0.01
Recreation, culture	11.9	0.0	0.2	-0.2	2.3	1.8	1.9	0.00	0.21	-0.02
Education	0.5	-	-	-	4.8	3.5	4.5		0.02	-0.00
Restaurants, hotels	6.2	-0.3	0.2	-0.5	2.3	1.4	2.3	-0.02	0.09	-0.03
Other	8.8	0.2	0.1	0.1	1.2	1.3	1.3	0.01	0.12	0.00
CPI-ATE	94	**0.2**	**0.2**	0.0	**2.1**	**2.2**	**2.1**			
Norges Bank est.			*0.2*		*2.1*		*2.1*			
Imported	33	0.2	0.1	0.1	1.1	1.2	1.1	0.07	0.41	0.05
Domestic	61	0.2	0.2	-0.0	2.6	2.6	2.1	0.12	1.61	-0.02
Energy, housing	4	-2.7	-5.0	2.3	-9.3	-12.0	-11.6	-0.11	-0.46	0.09
Energy, transport	4	-0.5	0.0	-0.5	-1.0	-2.1	-1.6	-0.02	-0.07	-0.02
CPI Total	101	**0.1**	**-0.0**	0.1	**1.6**	**1.5**	**0.3**	0.09	1.48	0.13

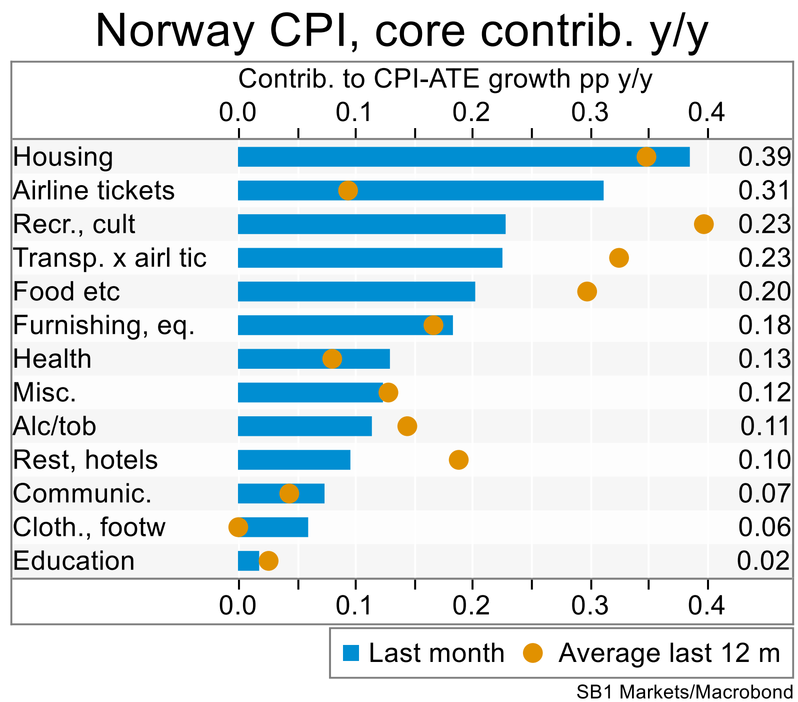
- Prices on furnishing and household equipments rose 1.3% m/m, we f'casted just a 0.2% increase
- Airline ticket prices are ridicolously volatile. This time prices increased more than we expected
- **CPI-ATE up 0.2% m/m and 2.2% y/y, annual rate 0.1 pp above our and consensus' f'cast**
- Imported prices are increasing much less than domestic, up just 1.2% y/y vs domestic at 2.6%
- Electricity prices fell 2.7% m/m (we expected -5%) and are down 12% y/y
- Headline inflation inched down to 1.5%, we assumed unchanged at 1.6%

Monthly changes are seasonally adjusted by SB1 Markets. The weighted sum of the components does not necessarily sum exactly up to the total. Norges Bank m/m s.a. estimate is implied, calculated by us

Airline tickets and housing are boosting core annual inflation

Yet, prices are rising in all major sectors; housing, airline tickets and culture drives growth up



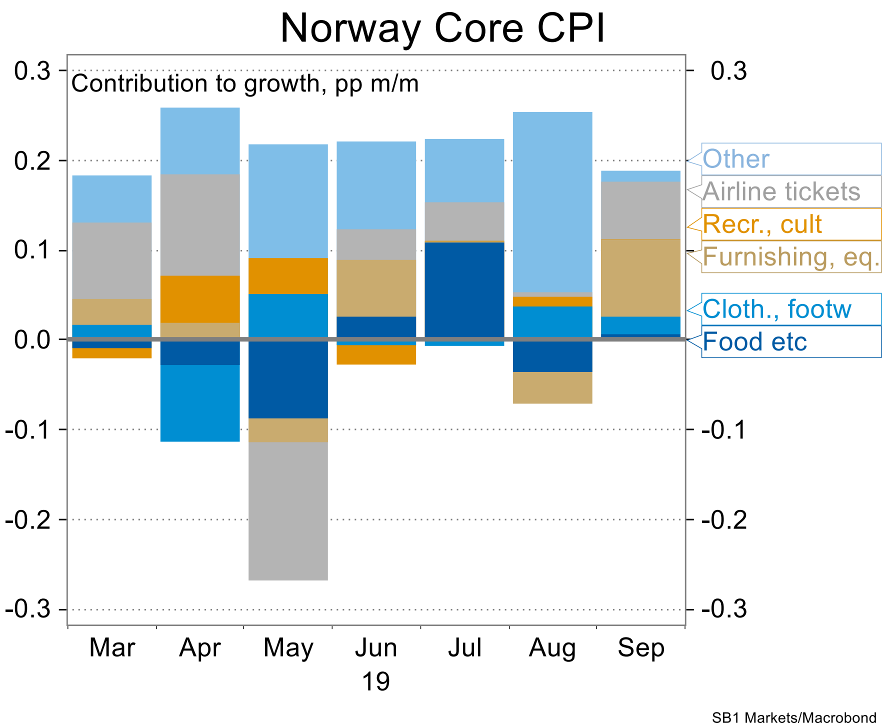


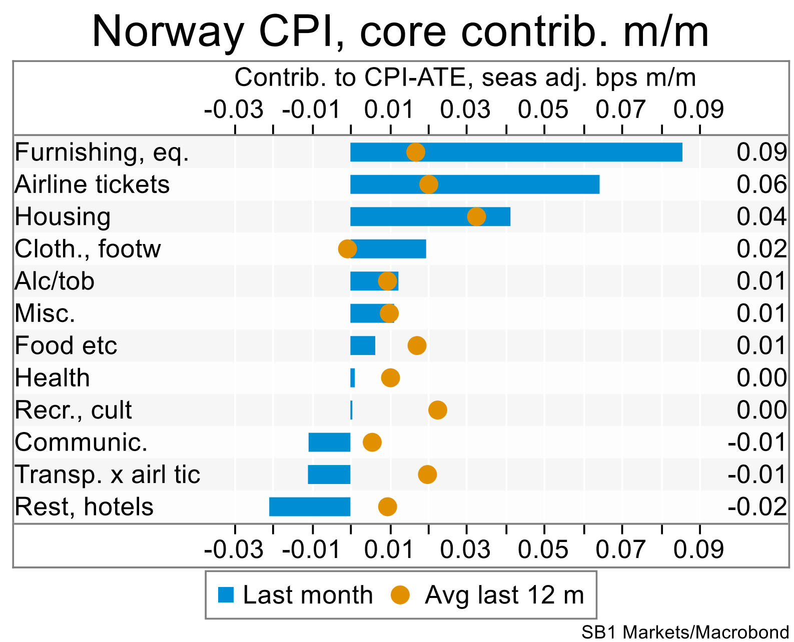
- Prices are increasing y/y in all main sectors. Airline tickets are up 25.5% y/y, which gives a 0.3 pp contribution on the annual rate. Housing (rent etc) contribute the most, by 0.4 pp.

SpareBank 1 MARKETS

Furnishing and airline tickets fuelled monthly inflation up in Sept

Most main sectors rose m/m, furnishing, airline tickets and housing were the major contributors

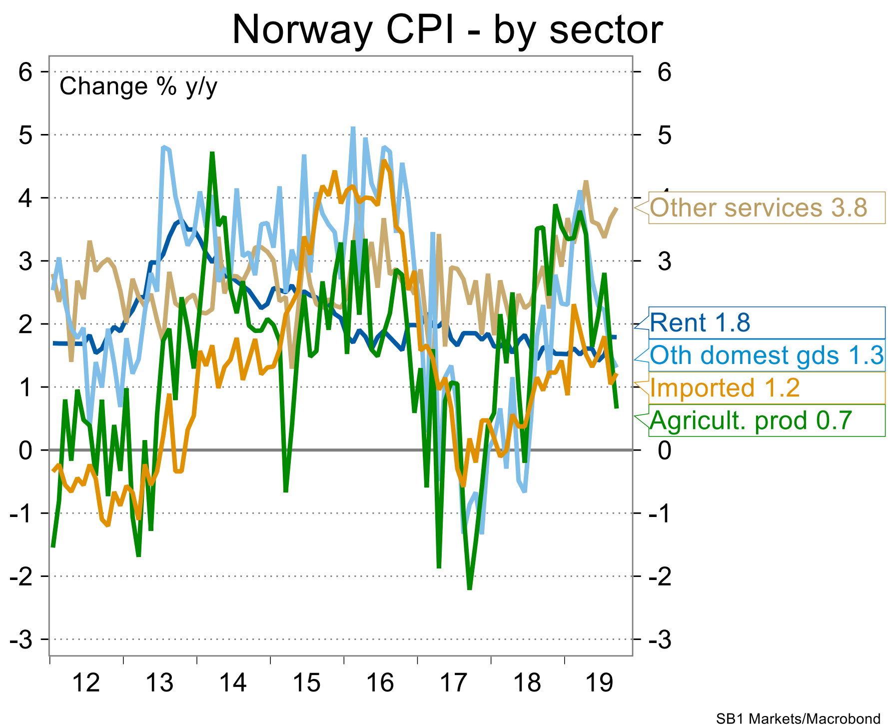


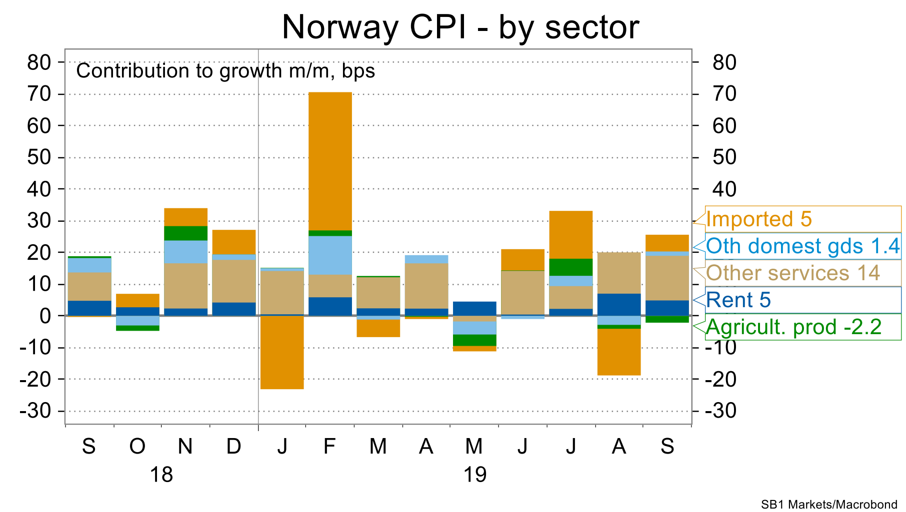


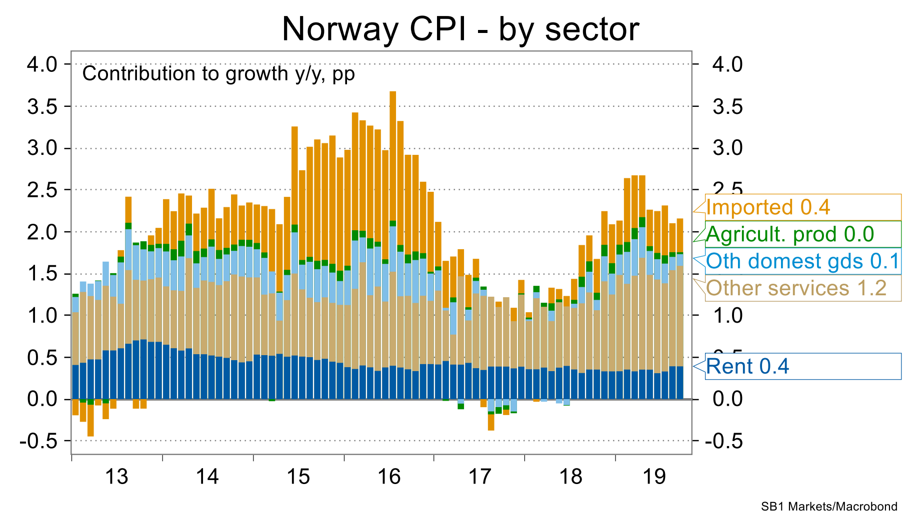
- Just restaurants & hotels, transport and recreation & culture fell m/m

Modest price growth on imported goods, domestic services are soaring +3.8%

Domestic services (culture, travelling etc) boost core inflation, other sectors are slowing/flat



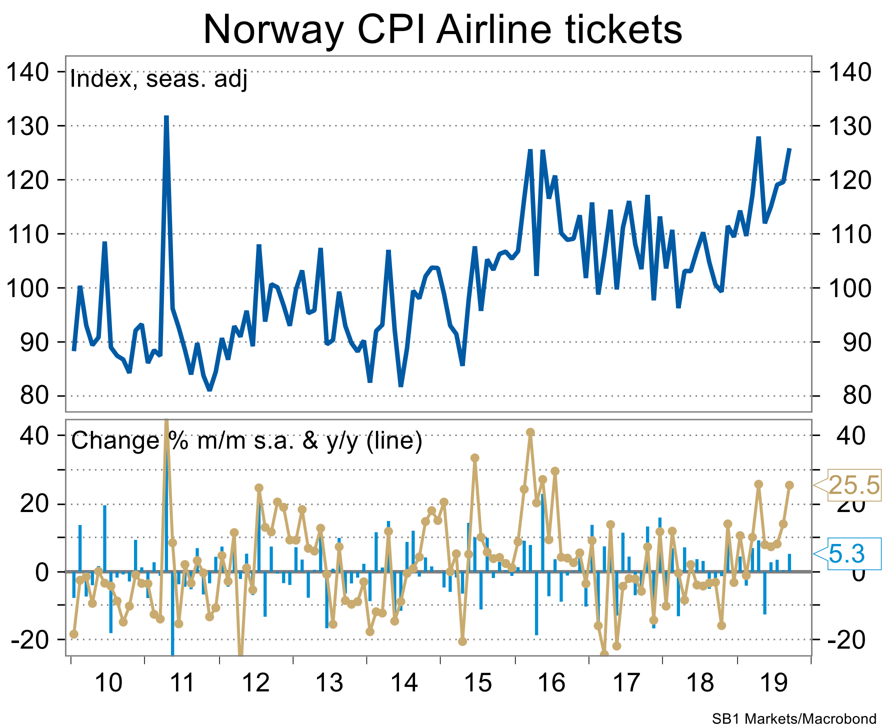


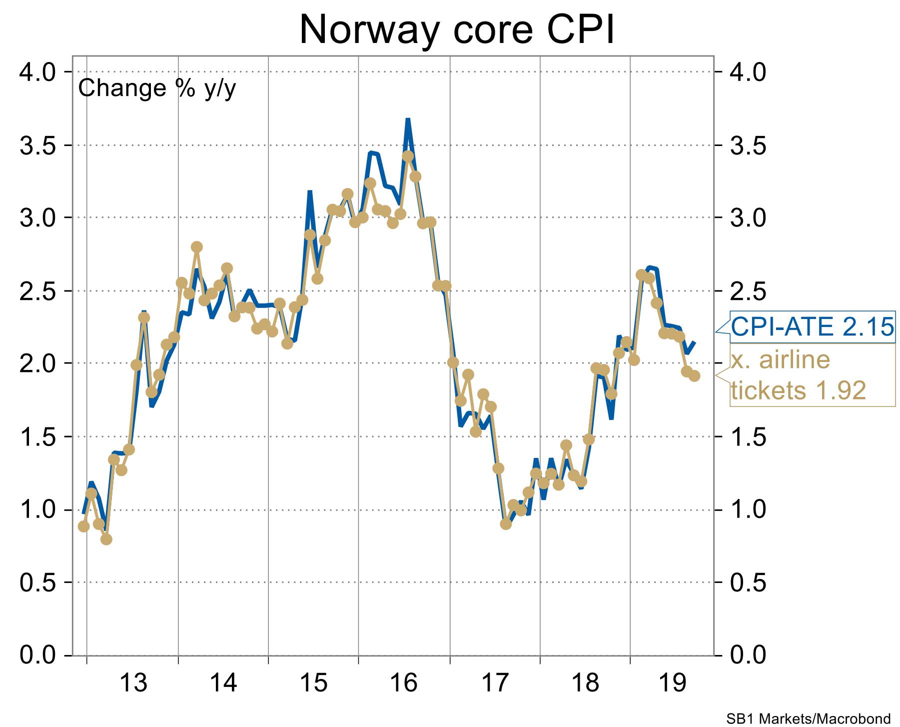


- Price growth in services are up 3.8% y/y. Other domestic goods and imported goods have slowed, after accelerating the past year. Rent inflation has been picked up the past 2 months, to 1.8% y/y
- The NOK depreciation has lifted import prices but the impact has been modest, and will probably remain so (check here)

Airline tickets prices surged in Sept, annual rate up 25.5%

Airline ticket prices are lifting core inflation by 0.3 pp!



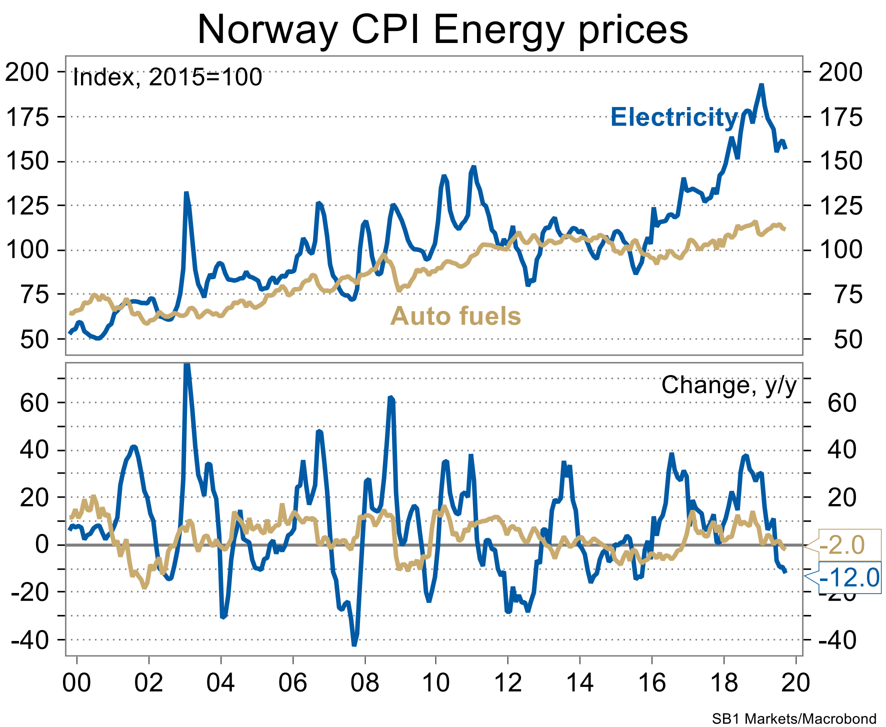


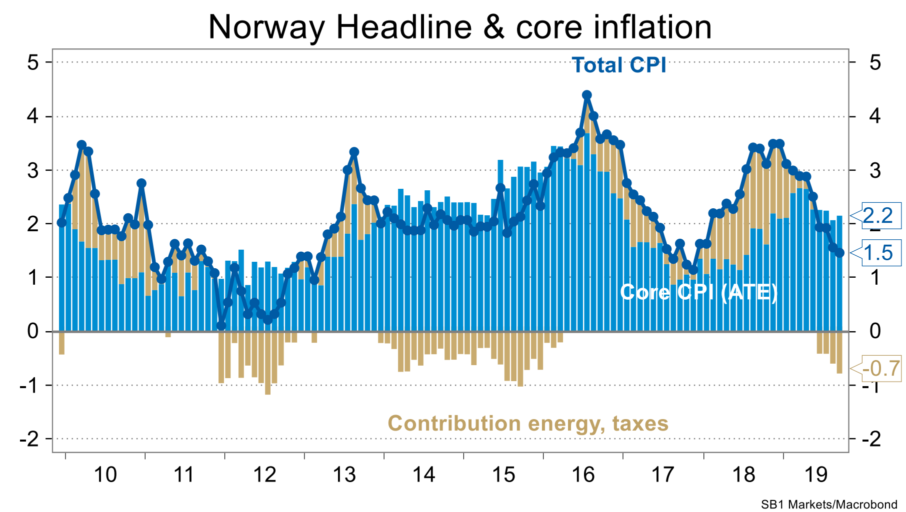
- Airline ticket prices rose 5% m/m (seasonally adjusted) and are up 25.5% y/y
  - » These data are very volatile

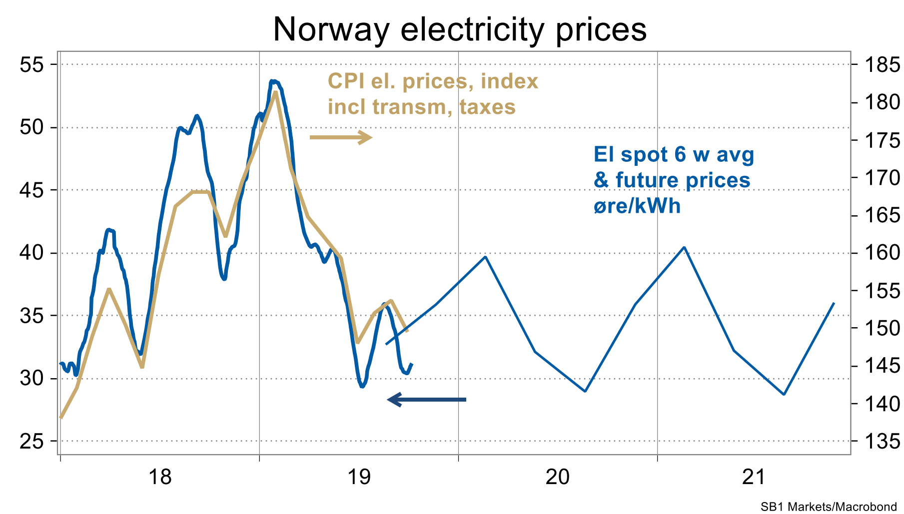
SSB is using a sophisticated net search model to calculate average prices in the relevant week. We assume that the real volatility in average monthly air ticket prices are lower than calculated

Electricity prices a 0.7 pp drag on headline CPI, not much downside left?

Electricity prices are down 12% y/y, from above 30% y/y in September last year



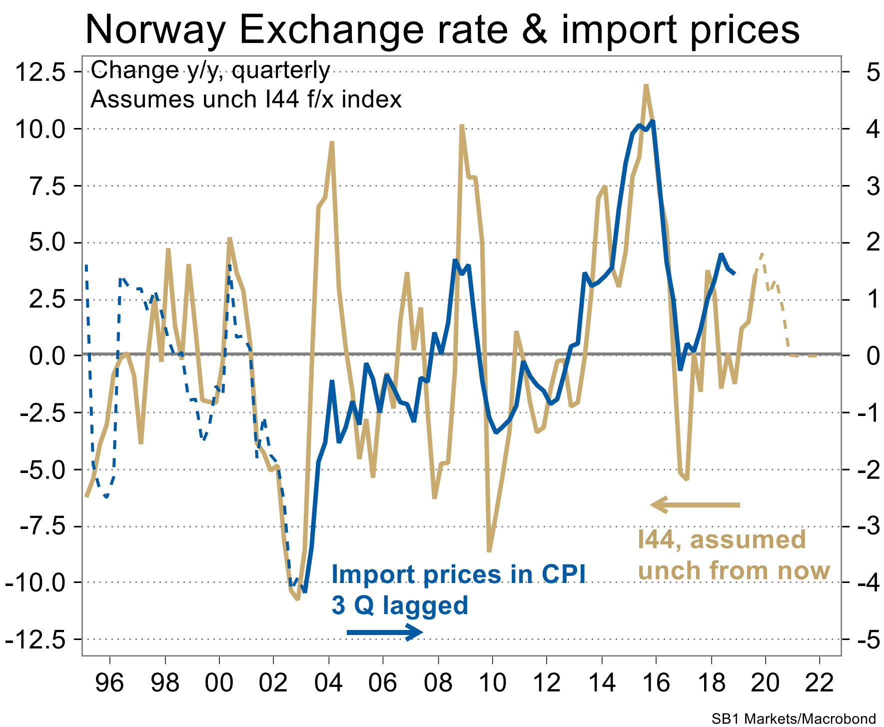


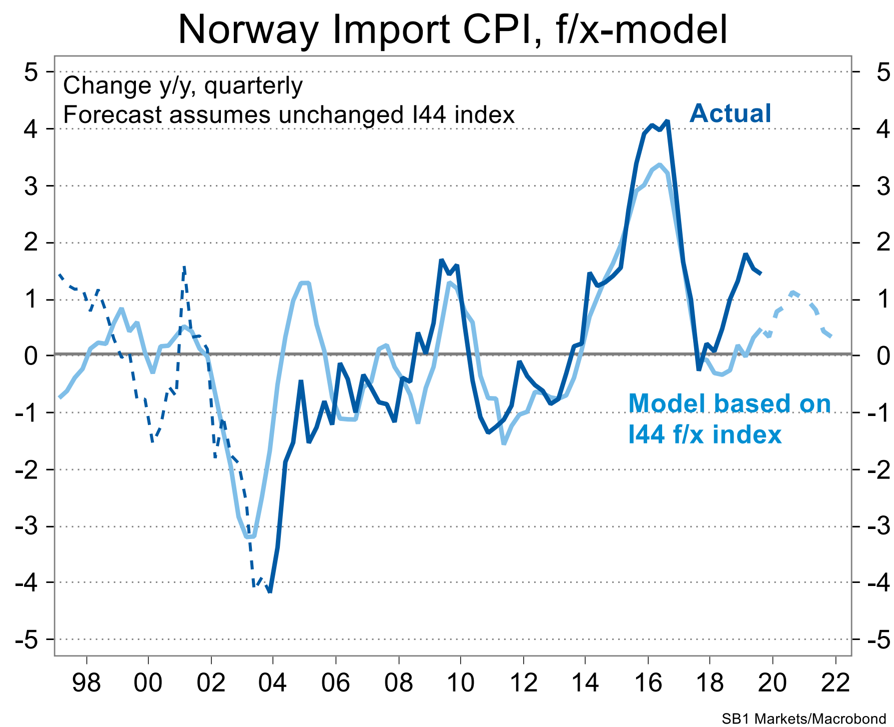


- In 2017/18 the surge in electricity prices lifted the headline CPI, reducing real disposable income significantly. Now, this effect has gone into reverse, as electricity prices are falling sharply. The y/y contribution was -0.7 pp in Sept, vs +1.5 pp last year
  - » Spot & near term future prices have stabilized recent months, after falling steeply in the spring/summer. The forward prices are indicating somewhat higher prices in Q4, the normal seasonal change. If correct, negative the contribution from lower el. prices will subside the coming months
- Auto fuel prices are close to neutral vs. headline CPI

Most likely, the impact from the weak NOK will remain modest

Imported inflation is now somewhat higher than the modest contribution which the NOK implies

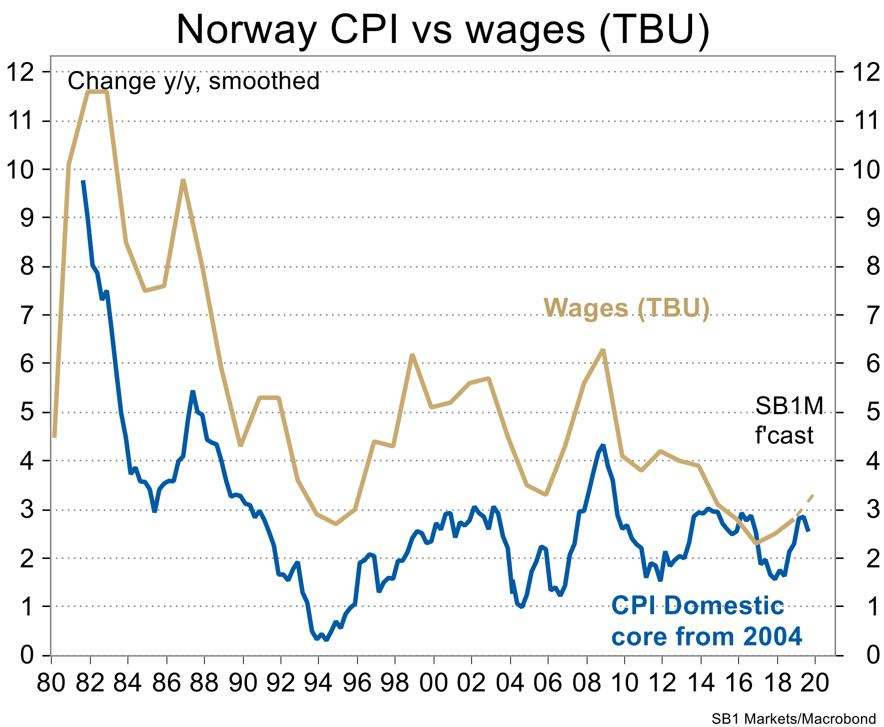


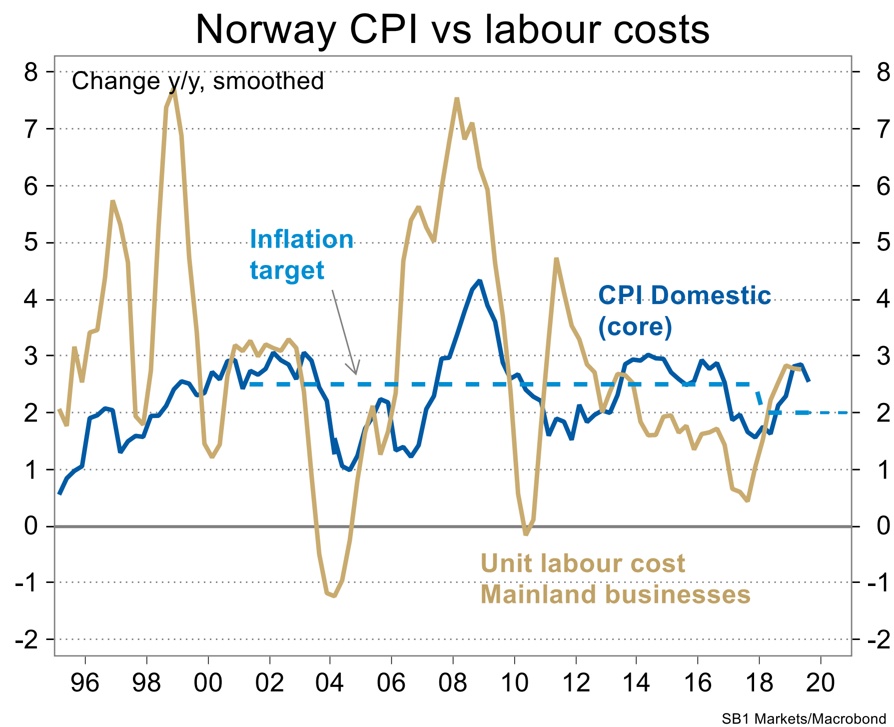


- In general, retail demand is so weak that it does not seem likely that the retailers are able to push up their margins. It does not seem likely that prices are accelerating abroad

Domestic costs: Wage inflation turning up, cost inflation above infl. target

Wage inflation is on the way up. Unit labour cost up some 2.8% y/y in Q2

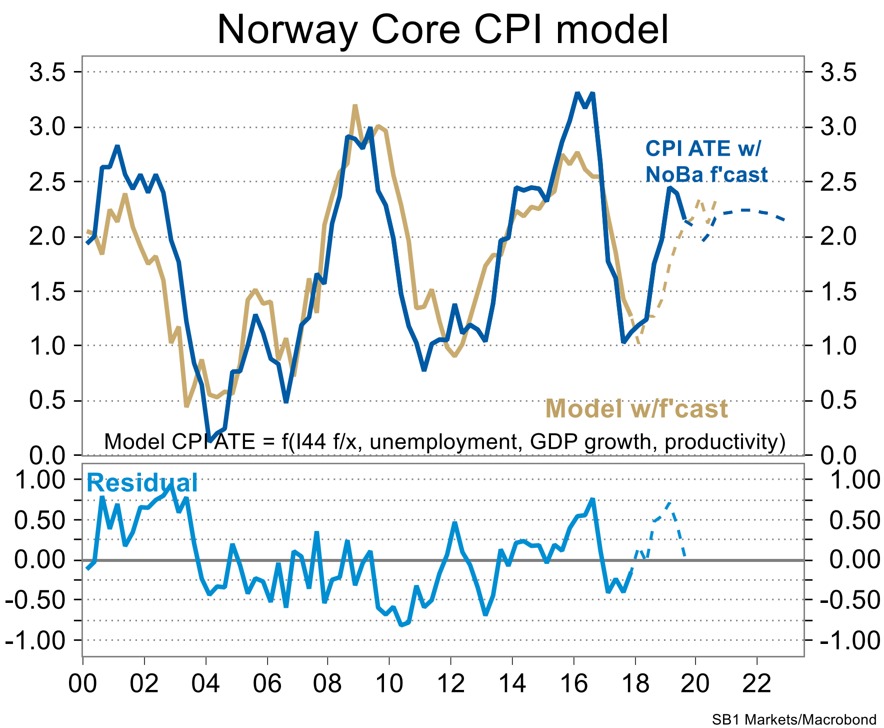




- Wage inflation is increasing and is now approaching 3%, will probably edge up to 3.2% in 2019
- Productivity growth remains meagre
- (Underlying) Unit labour costs inflation up to 2.8% y/y in Q2 (smoothed), unchanged from Q1 and up from 2.2% one year ago – and from below 1% in 2017

The outlook: Not much upside left, core CPI inflation has peaked?

Actual inflation close to the model forecast now – and it suggest 2.3% in a year's time

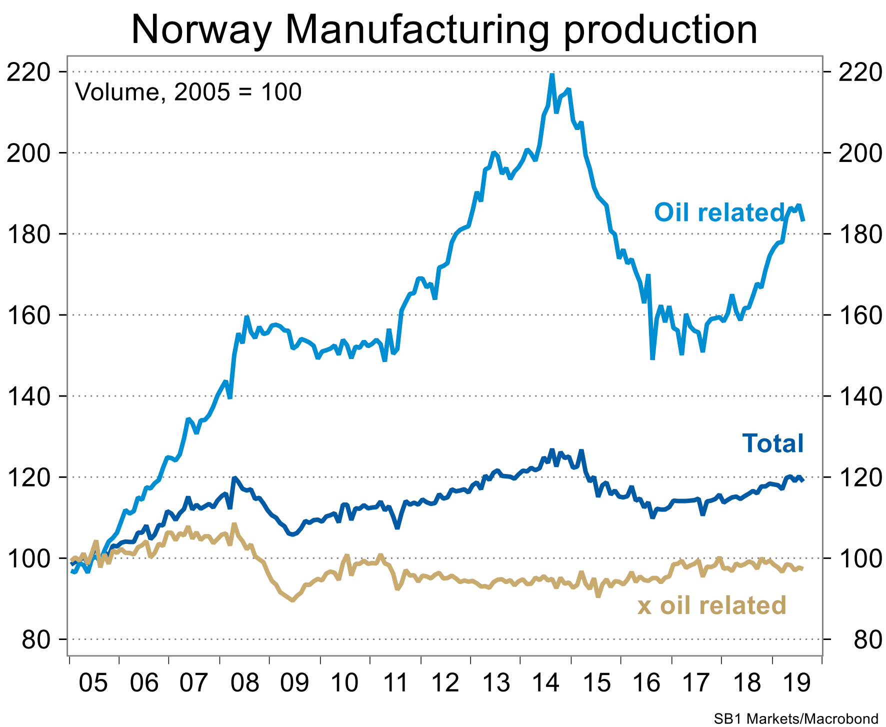


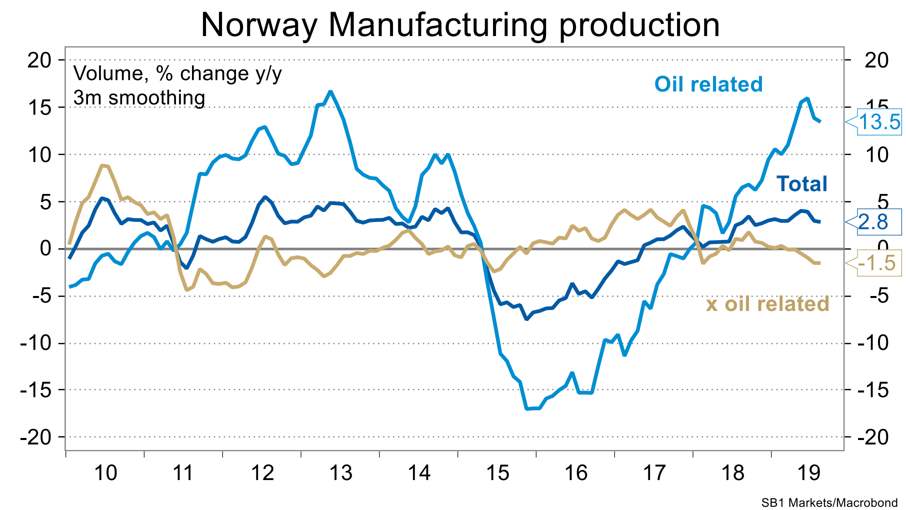
- Core CPI growth was running well above the model f'cast in Q1 and Q2. In Q3, inflation slowed to 2.2%, which is spot on the Q3 model f'cast
- The model, which includes unemployment, GDP and the NOK, signal steady inflation the coming year, up to 2.4% in Q2 2020
- Norges Bank expects core CPI at 2.3% in 2019, and down to 2.1% in 2020 (Sept Monetary Policy report). Probably fair estimates.

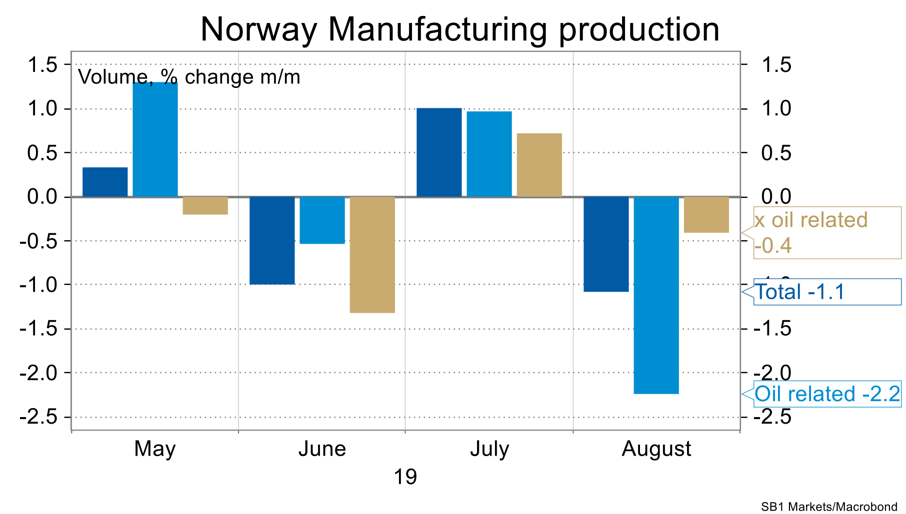
SpareBank 1 MARKETS

Manufacturing production retreated in Aug. Oil related close to peak?

Production slipped 1.1%, reversing the July jump. Annual rate moderate at 2.8%, flattening out



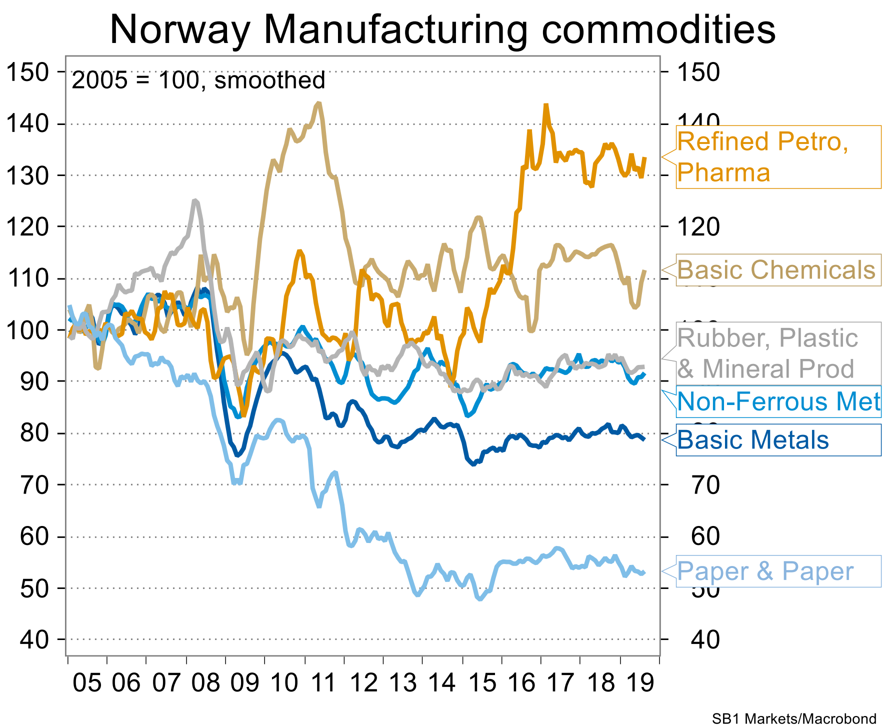


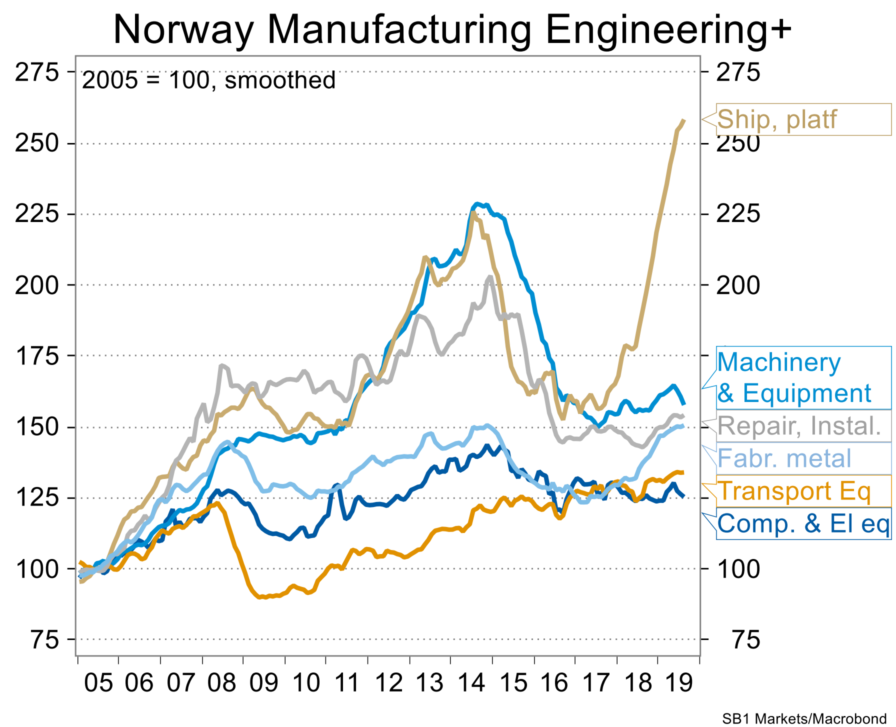


- Total manuf. production fell 1.1% in Aug, well below expectations. Underlying growth has slowed to 1.2% and the annual rate has flattened out, at 2.8% in Aug (smoothed)
- The upturn has primarily been driven by oil-related manufacturers, which are up 13.5% y/y. However, we assume the oil investments – and thus oil related production will (be close to) peak in H2
- Non-oil related sectors were flat through 2017/18 but has fallen marginally in 2019 – and is down 1.5% y/y
- Surveys have softened and point to weaker growth going forward

Production of ships & platforms still soaring, commodity sectors not impressive

Most engineering sectors are trending up, machinery & equipments slowing now?

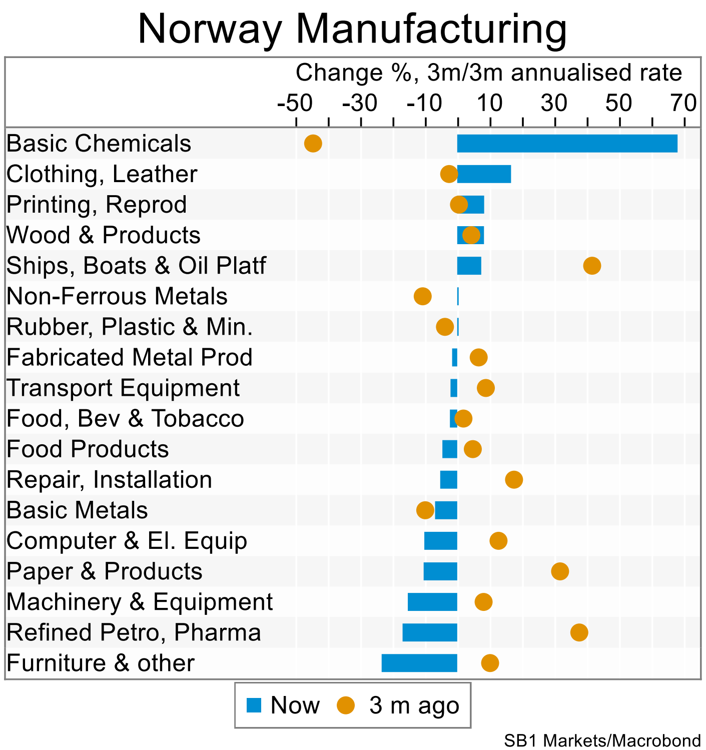


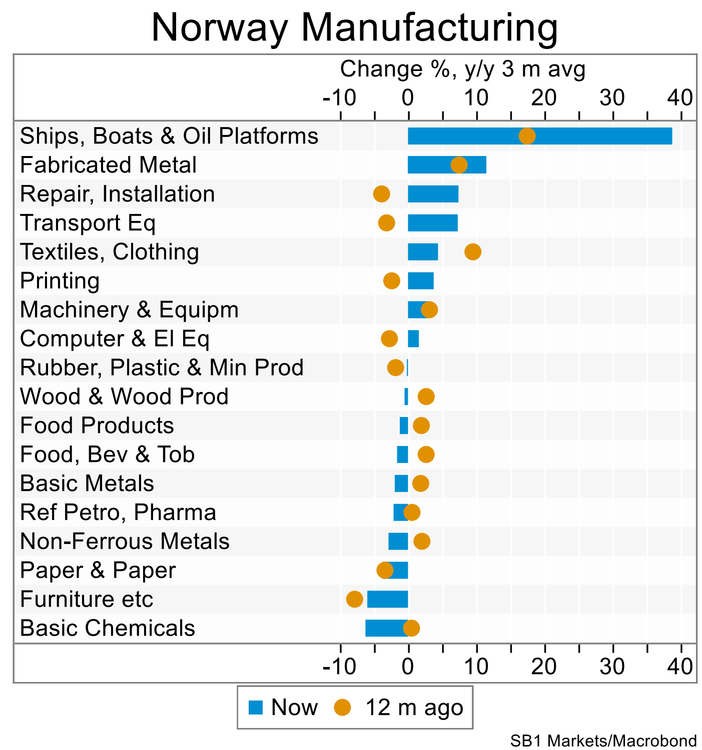


- It's almost as we do not believe it, production of ships and platforms is now 15% higher than at the 2014 peak, in volume terms. However, overall petro related manufacturing and support activities are down some 14% from the peak in volume terms
- Engineering sectors: ships & platforms are still surging (although production fell in August), followed by other partly oil-related sectors; both fabricated metals, repair & installation are accelerating. Machinery & equipment losing some steam?
- Commodities: Several sectors have turned up recent months but none are impressive, even refined petroleum and pharmaceuticals are not more than flat. Basic chemicals have recovered from the May plunge but the trend is down

Production of ships & platforms boosts growth, not much elsewhere

Production is increasing in 5 sectors and accelerating in 4, while 11 sectors are declining (2 flat)

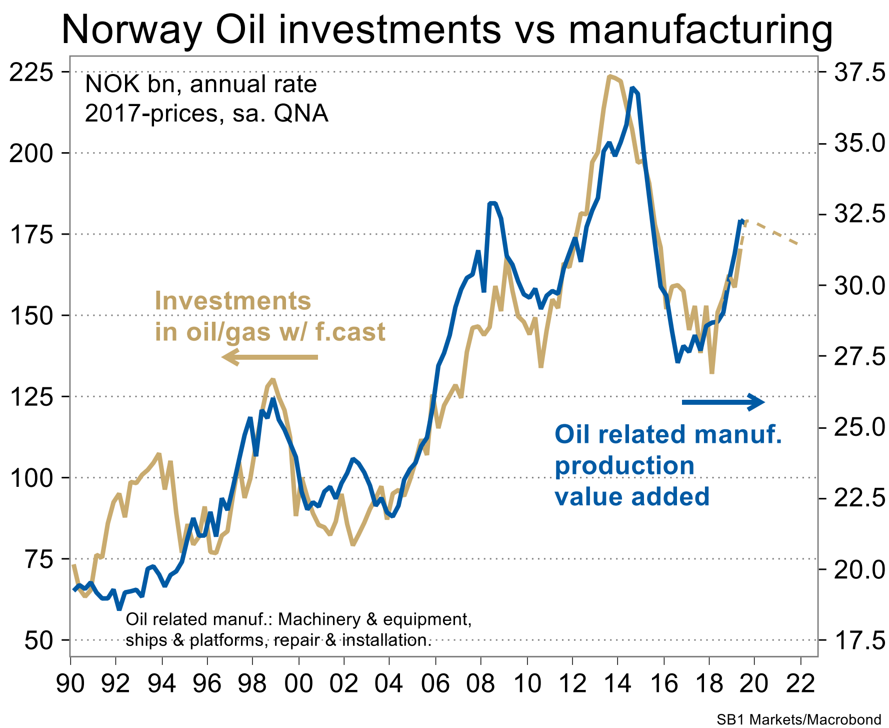




- Ships/platforms production is up 39% y/y (smoothed), an acceleration from 17% one year ago
- Not that impressive in other oil related sectors; machinery up just 3% y/y, repair & installation up 7%
- Fabricated metals and transport equipment are growing strongly at 11% and 7%
- Production of baric chemicals, furniture, paper and non-ferrous metals and refined petro, pharma are declining y/y

How large is the upside in oil related industries? Not much…

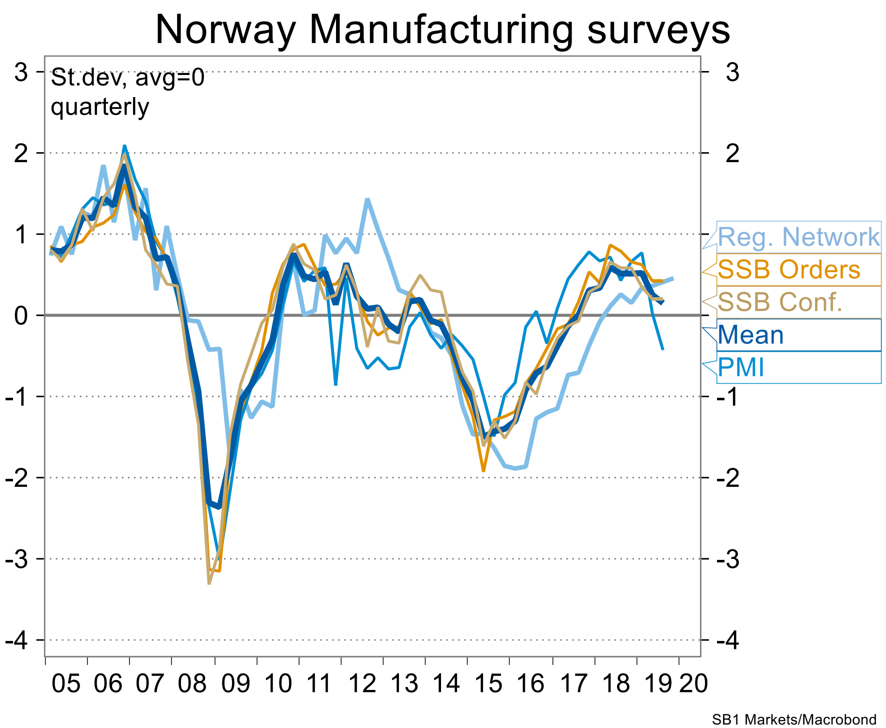
In H2, oil investments will probably be close to our 2020 estimate

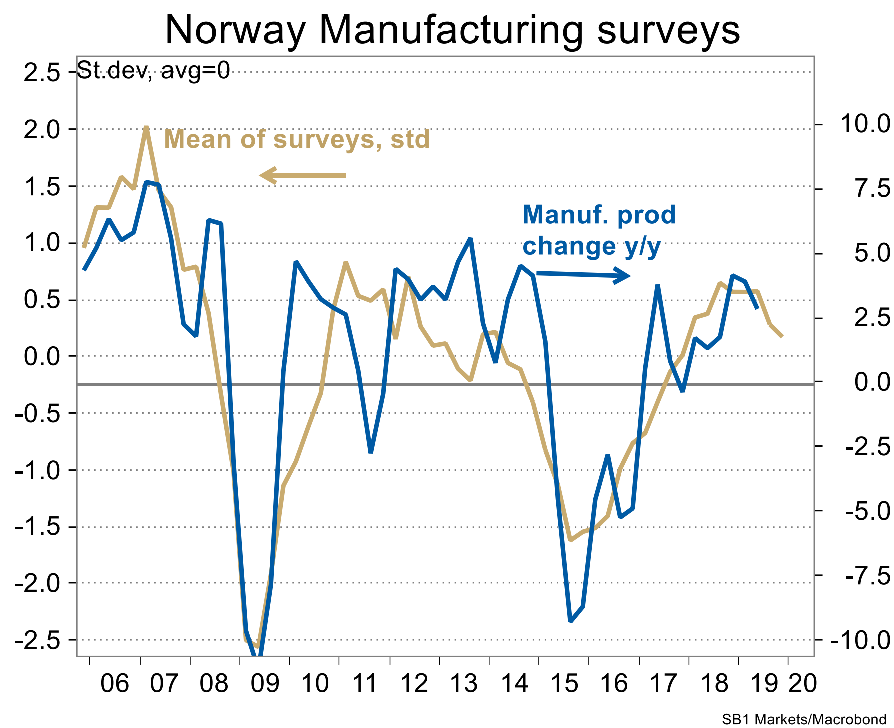


- Production in oil related industries have soared since late 2017, closely correlated to the increase in oil investments, as reported in the National accounts
- Oil investments will probably come close to the local peak now – during H2 – at some 6% above the Q2 '19 level
- If correct – and if Norwegian manufacturers do not gain market shares from foreign competitors – oil related production will soon flatten out
  - » Neither Norges Bank's regional survey (in Q3), SR-bank's regional survey (Q3) nor SSB's manufacturing survey (Q2) signal an immediate halt in growth – while the PMI, which covers the whole manufacturing sector signal close to zero growth
- Some extra negative signals: Both manufacturing and power supply investments are expected sharply down in 2020, according to SSB's investment surveys for these sectors

Manufacturing surveys signal a slowdown in production

All manufacturing surveys x Regional Network have softened, PMI at the bottom

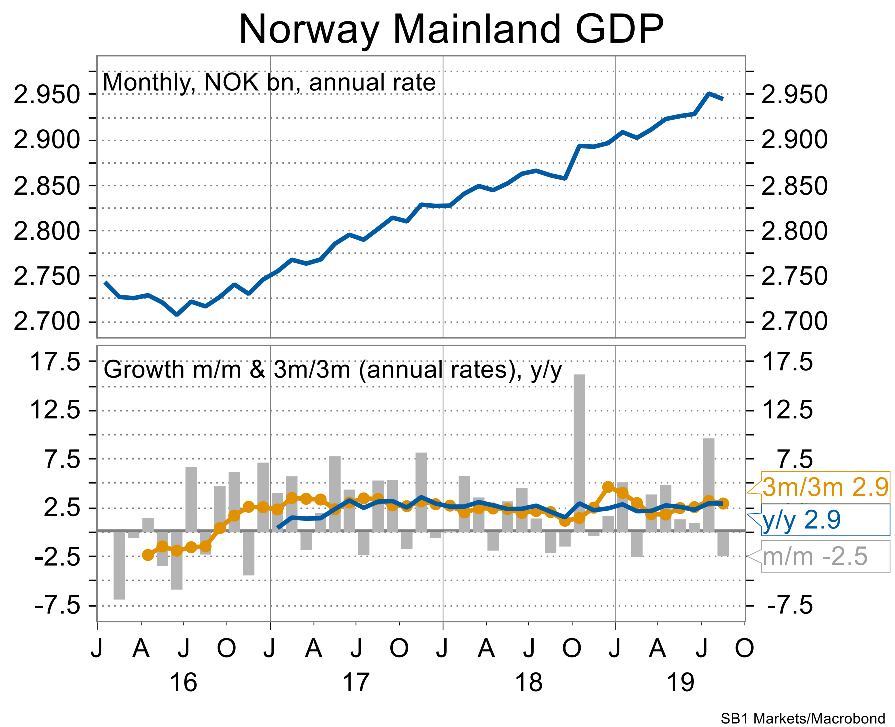


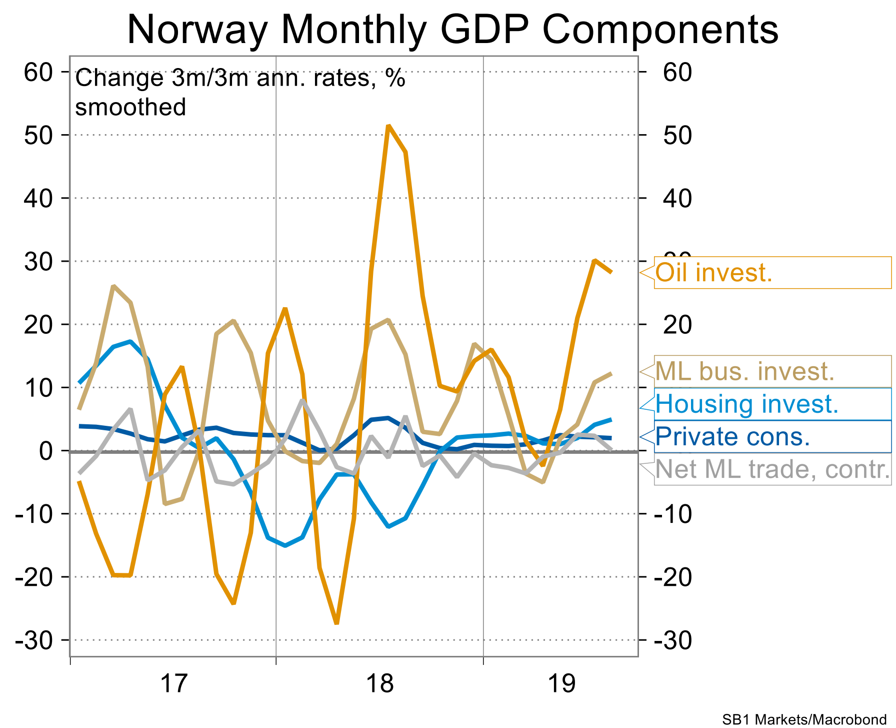


- The PMI is the weakest of the surveys. All surveys x the PMI are above their respective averages and are still signalling growth, however, at a lower pace than the past year. The avg of surveys point to decent (at least 1.5%) growth
- Unlike the others, Norges Bank's Q3 Regional Network does not report decreasing growth. This survey is probably the most trustworthy and also the one which NoBa prefer
- <u>The sum of surveys still suggest that the production growth peak is behind us</u>

GDP growth retreated less than expected in Aug, a solid Q3 so far

GDP fell 2.5% m/m annualized in Aug, following a 9.6% spike in July. Underlying growth solid at 2.9%

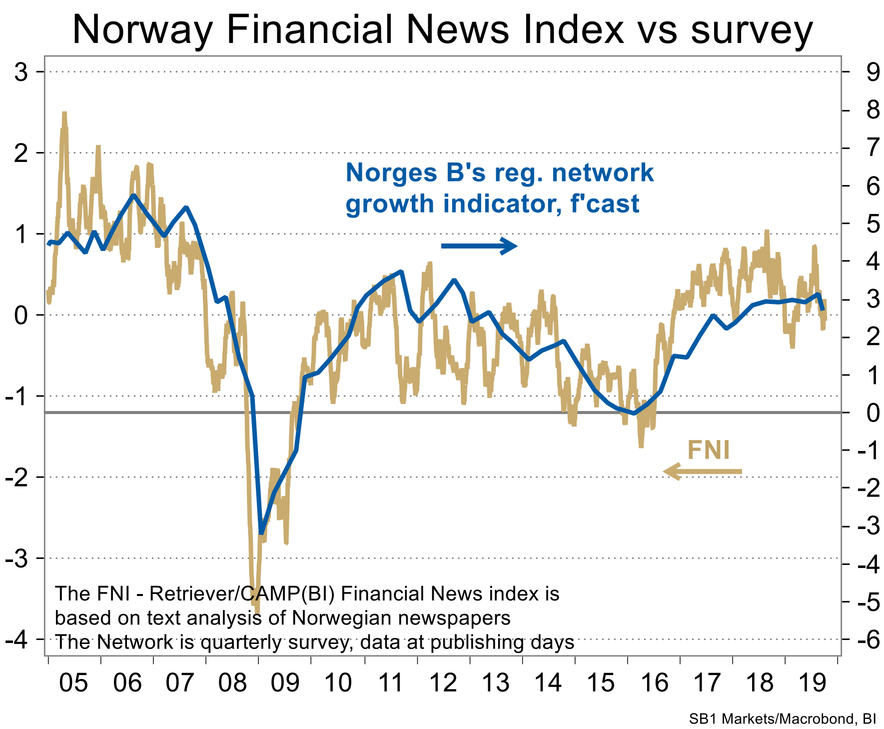


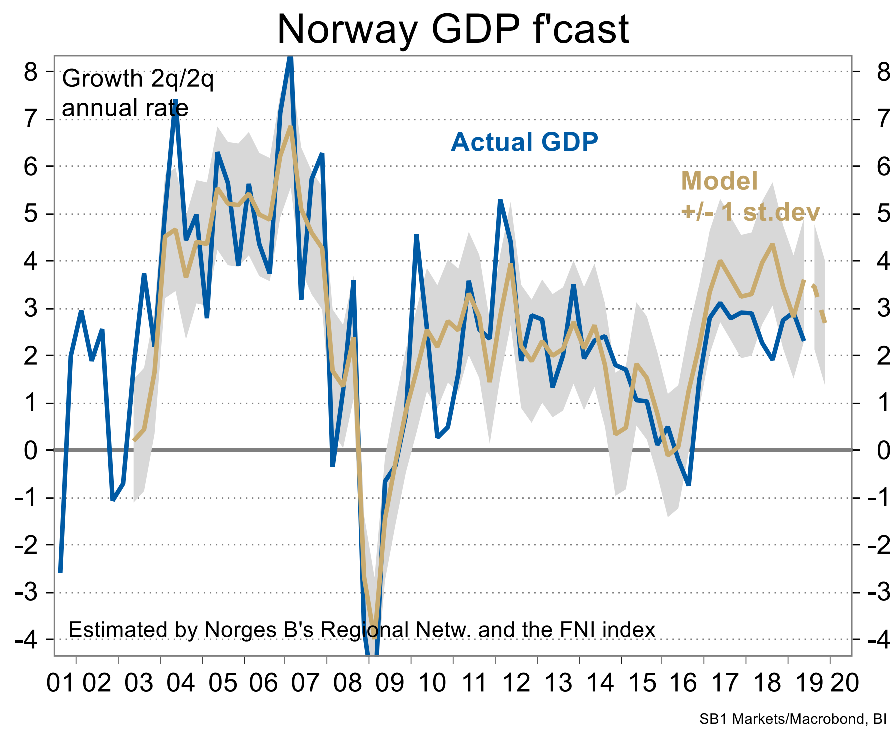


- Mainland GDP fell 0.2% m/m in August (we expected -0.8%), equalling a 2.5% annualized rate. The downturn came as no surprise after the 9.6% jump in July (revised down from 12.2%). The monthly data are too volatile to give us any useful signals, but underlying growth at 2.9% (measured 3m/3m) confirms that growth is still above trend. Zero growth in Sept yields a 2.9% q/q annualized rate in Q3, a small decline in Sept is not unlikely
  - » Norges Bank's implicit Q3 f'cast (from the Sept MPR) is 4.0% q/q annualized, lifted by electricity production, and a slowdown to 2% in Q4
  - » GDP is up 2.9% from August last year, of course 'artificially' boosted by the strong July this year
- <u>On the demand side:</u> Private consumption is growing moderately. Mainl. business investments rose sharply in July, slowed marginally in August. Oil investments have been soaring (based on oil companies' est), our take is that we are now close to the local peak. Housing investments are growing modestly, a modest acceleration recent months. Mainland net trade has turned to zero

The Financial News Index steady in Sept, history revised up

Reports on the economy have been more negative since mid-July but still better than early 2019





- Trade tension market turmoil, and a few softer key macro indicators have created more a more negative news flow in financial media since mid-July. The FNI, which tracks media reports on the economy, was steady through Sept
  - » The FNI was revised up through 2019, the August level up from an index close to -0.4 to + 0.02
- The index does not signal lower growth

Financial News Index is based on an analysis of text in Norwegian newspapers covering the economy, tracking ‘economic’ words and assessments. The index follows the cycle well but is rather volatile, short term. The FNI is published by Retriever/CAMP(BI)

Highlights

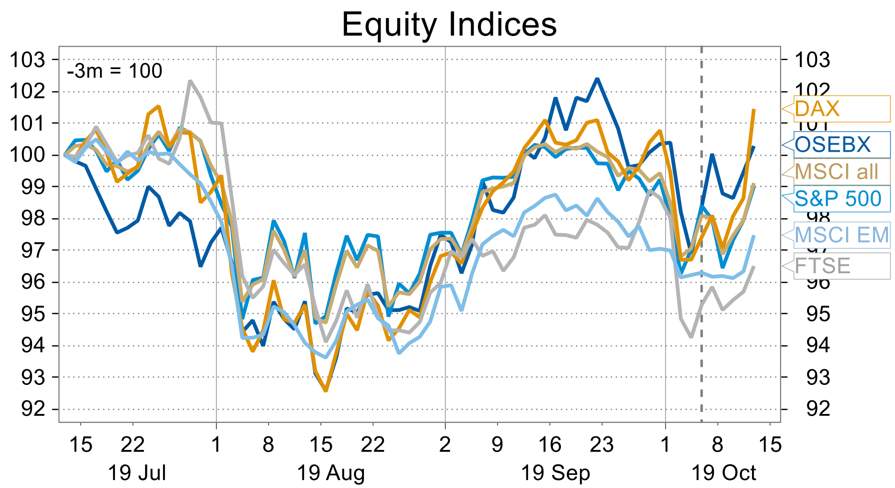
The world around us

The Norwegian economy

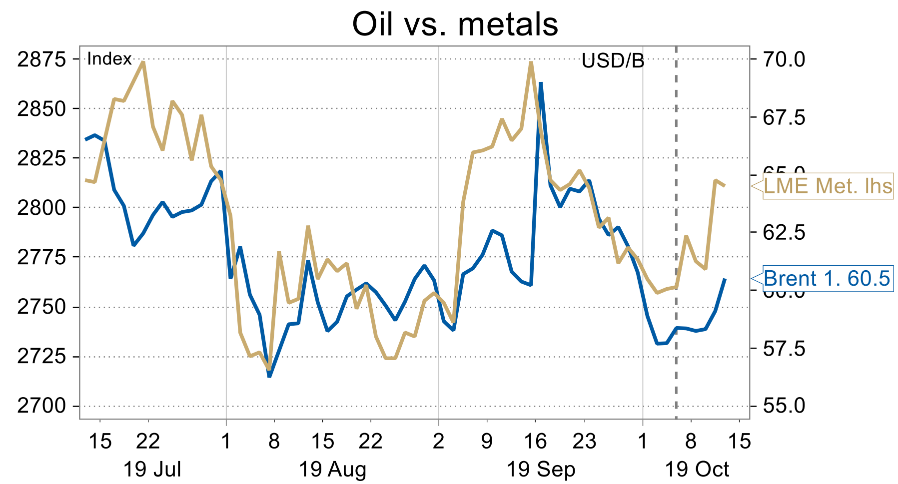
Market charts & comments

A narrow trade deal is better than none, good Brexit news, Fed will buy. Hurray!!

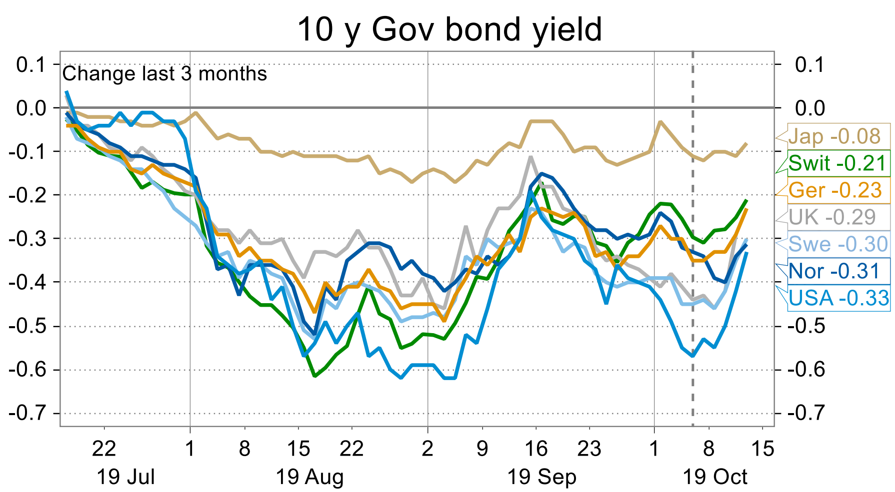
Both bond yields, stocks, oil, metals sharply up at the end of the week. The GBP +3%!



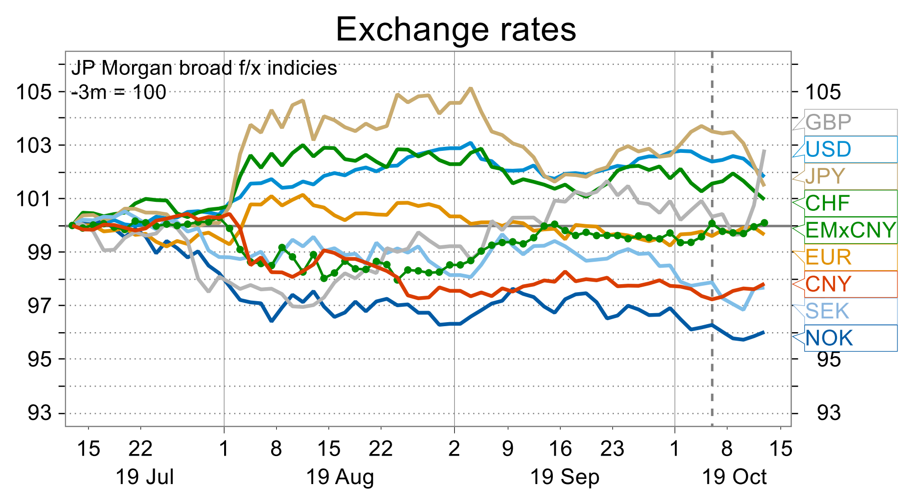
Stock markets turned up Wednesday/Friday, everywhere



Up, up!



Bond yields straight up. US 10 y bond rose 24 bps (almost 2 std.dev) on the week, and UK yields increased equally, on positive UK & Ireland Brexit talks



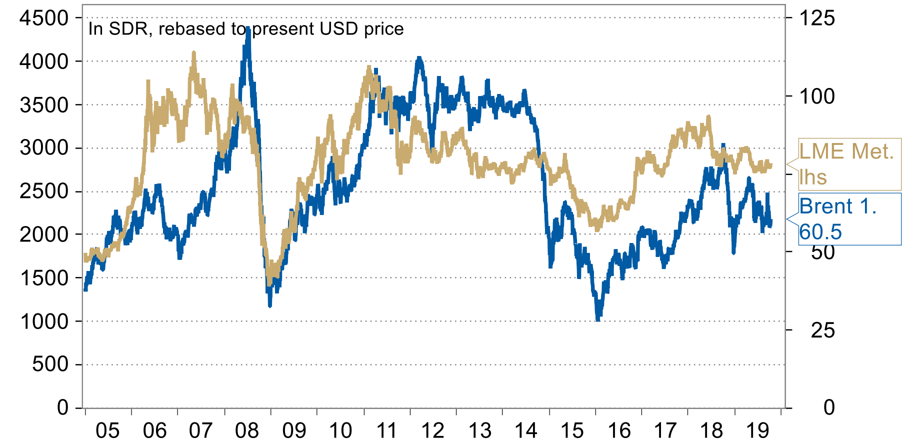
USD & JPY weakened, GBP steeply 3% on encouraging Brexit news, SEK recovered somewhat, NOK more or less flat

In the long run: Bond yields close to ATLs, US stock markets not far below ATHs

The trade war rules. And then some economic data. Volatility is probably here to stay

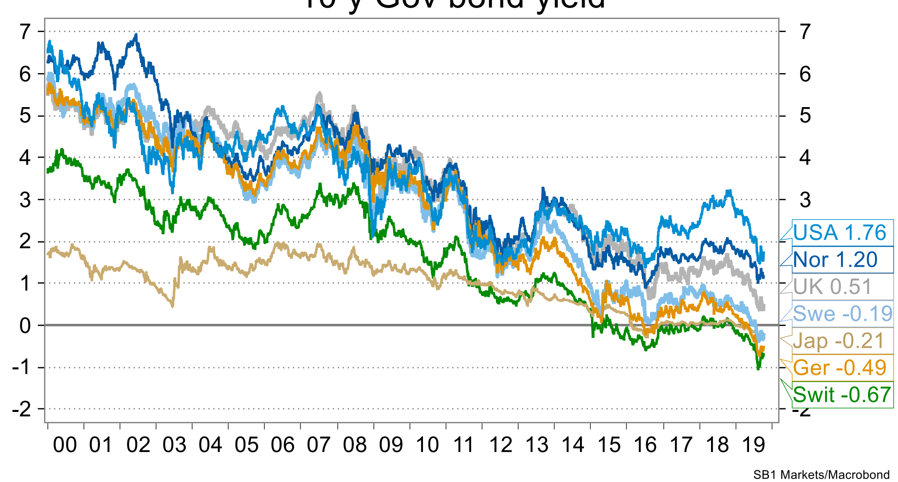
Equity Indices

Oil vs. metals

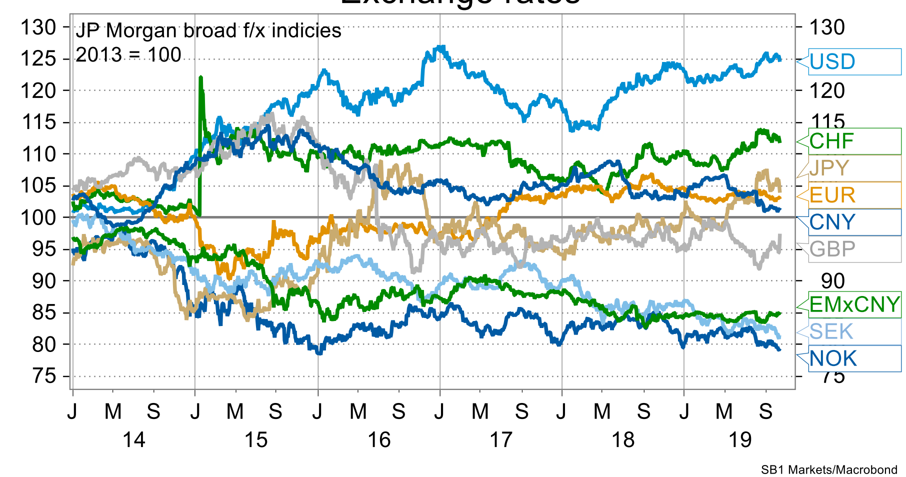


Metal prices may be trending down but slowly and the decline from the local peak is not large

10 y Gov bond yield



Exchange rates



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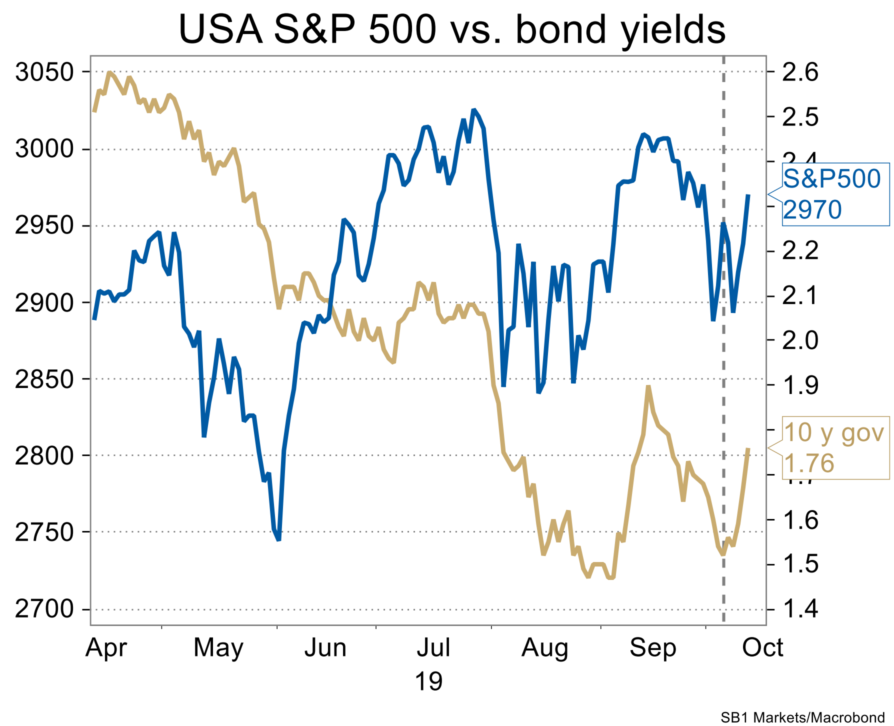
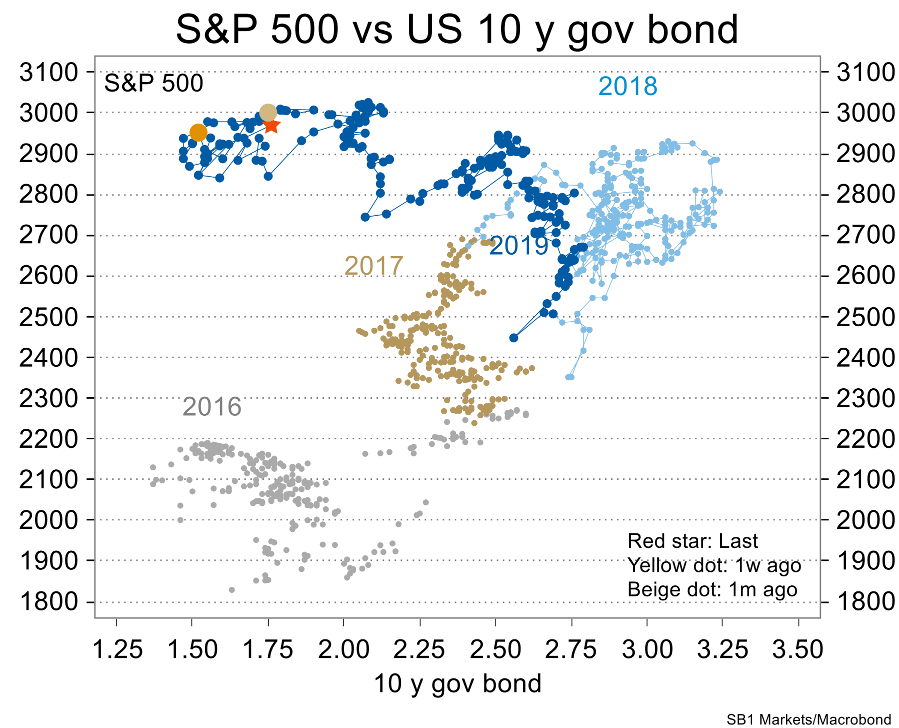
US: Both bond yields and stocks rebound on trade deal news (déjà vu?)

10 y bond up an impressive 24 bps, S&P up just 0.6% (but by 2.7% from Tuesday)





- There were no major surprises among the key macro indicators released last week, markets rose on the trade narrow ‘deal’ with China, good Brexit news and the surprisingly large Fed program to supply liquidity in the money market

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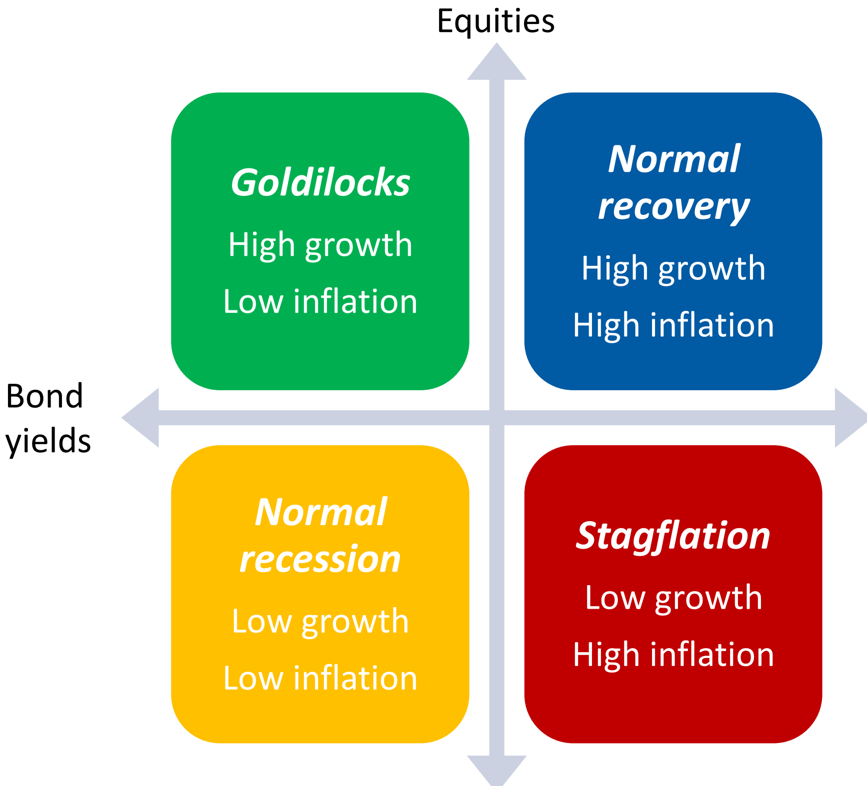
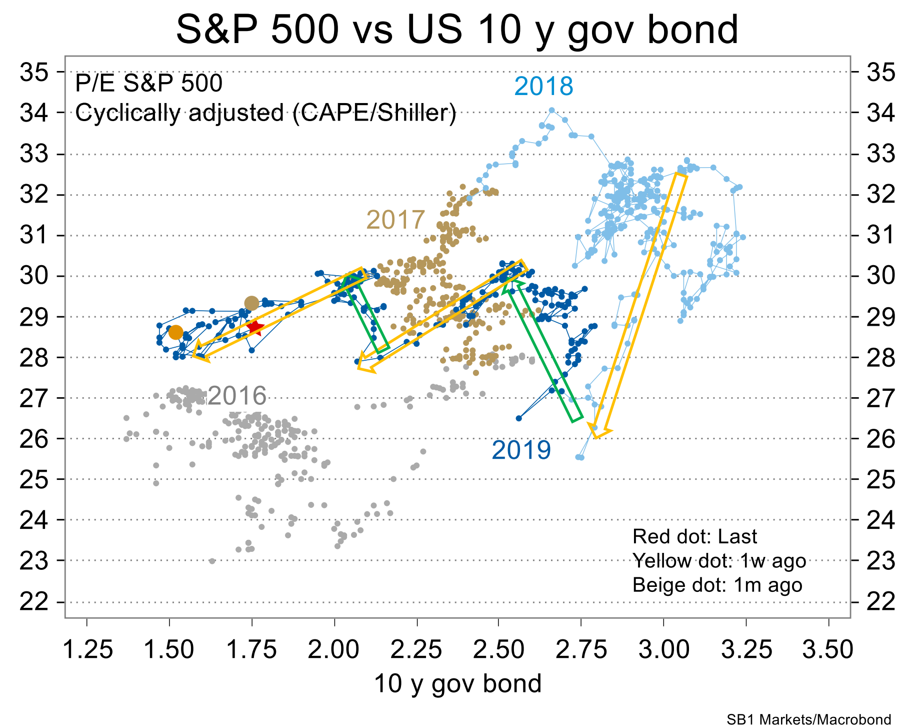
US markets moved away from the recession corner last week

Stocks/bonds are almost back to where they came from one month ago

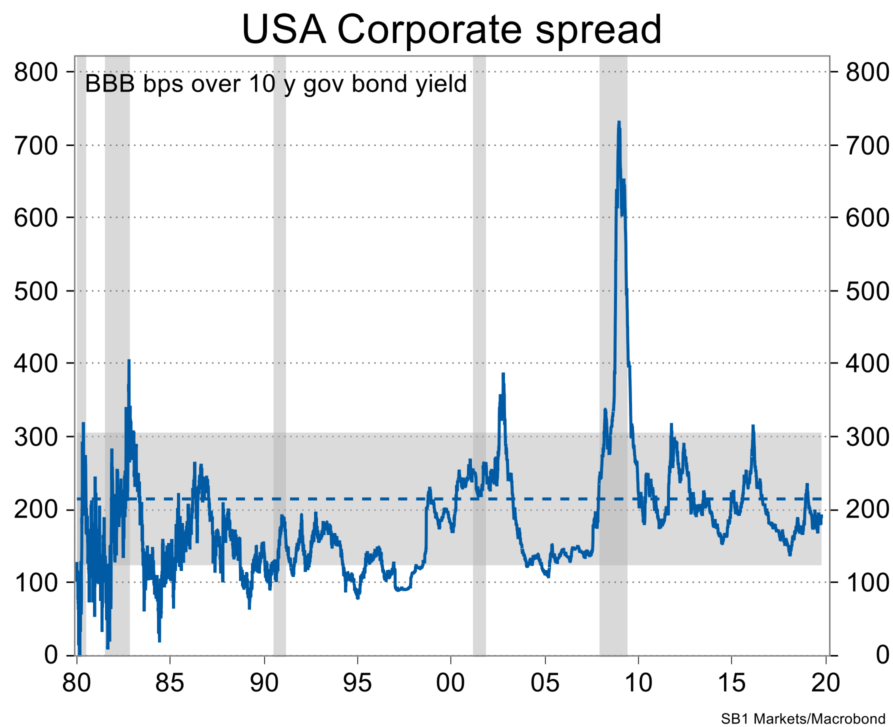


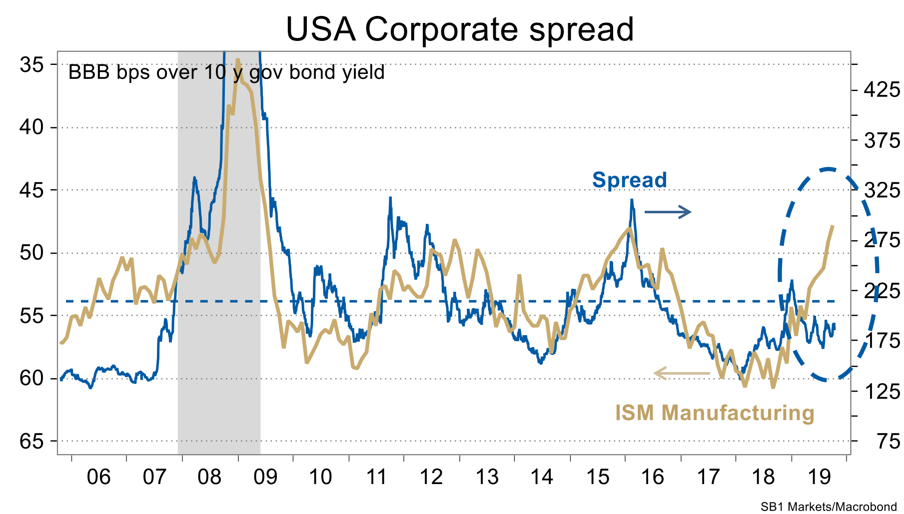


- Recent months, markets have been zig-zagging along with developments/news on the trade war. In August, markets moved towards the recession corner following the bad trade policy news. In early September, both markets were recovering, on hopes of a trade war de-escalation and some upbeat US macro data. Last week, trade news were positive, and market recovered, again – out of the recession corner
- We do not think a long term Goldilocks scenario is likely. If yields decline substantially form here, it will be due to really weak economic news, which will not be good news for the equity markets. We are not that worried for the 'Stagflation' corner either; a take off in inflation will happen only if central banks make serious policy mistakes, over time. Trump wants the Fed to do just that but we doubt he will succeed. So, the normal recession/recovery axis is the most likely – and now we are heading towards the recession corner

Credit spreads down last week, are below an average level, far too low?

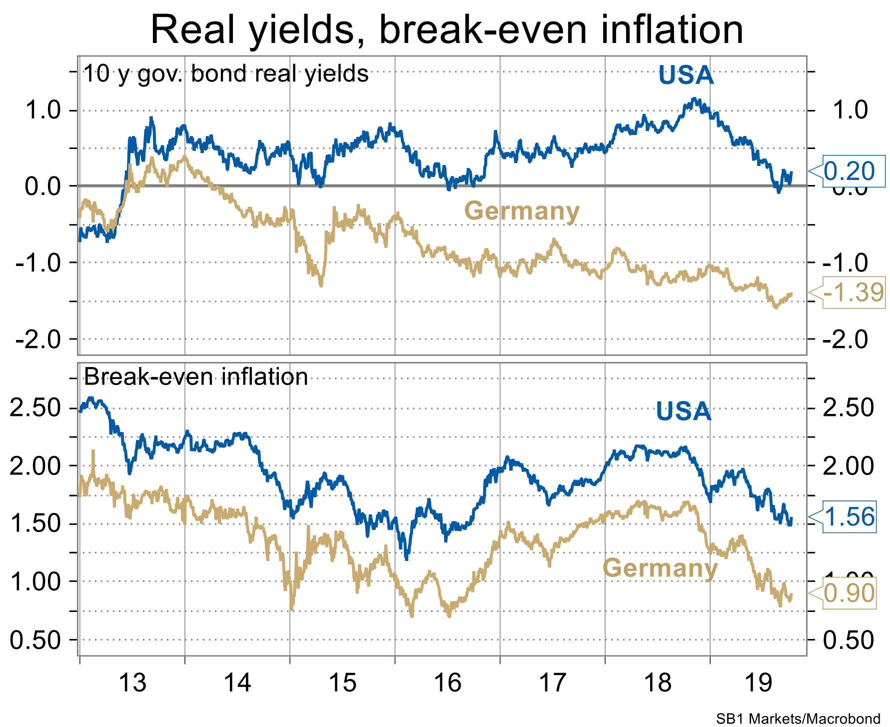
Spreads are <u>far too low</u> if the ISM and (most) other surveys are correct; that is, <u>*if growth is slowing*</u>

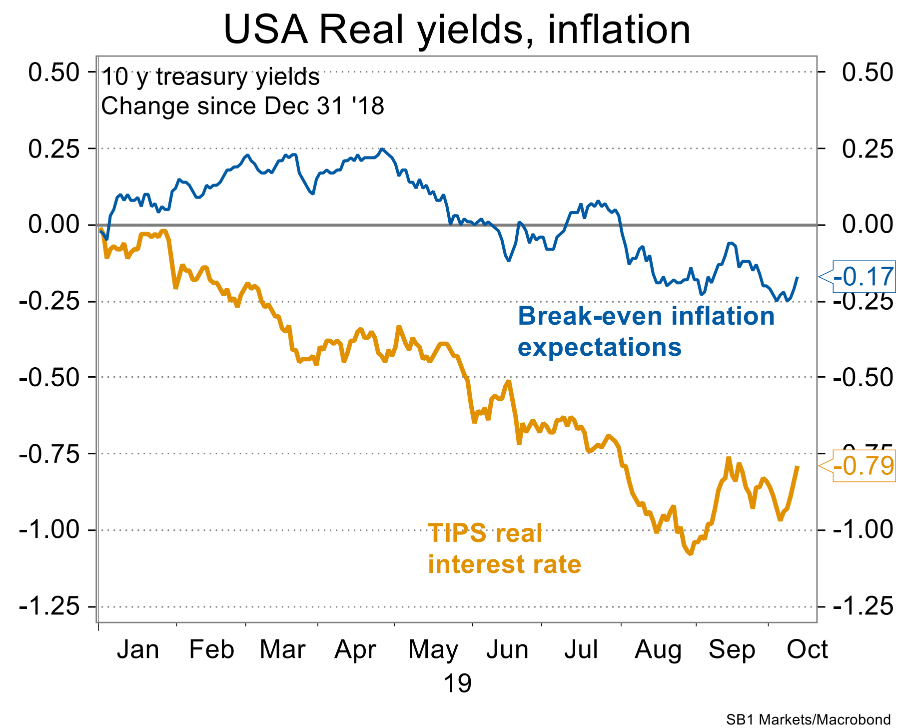




US real rates drove nominal bond yields up last week

US real rates up to 0.20%, Germany remains extremely low at -1.39%





- Both real rates and break even inflation have been heading steeply down this year, in US and Germany. Since early Sept, real rates have recovered much better than inflation expectations, probably primarily due to hopes of a trade war solution
- German real rates bottomed out at 1.6% in late August and have edged up to -1.39%, which is still ridiculously low. Inflation expectations at 0.87% does not seem that far off, although far below the ECB's price target at close to 2%
- US inflation expectations rose marginally to 1.52% last week, the real rate bounced to 0.15% (from 0.02)

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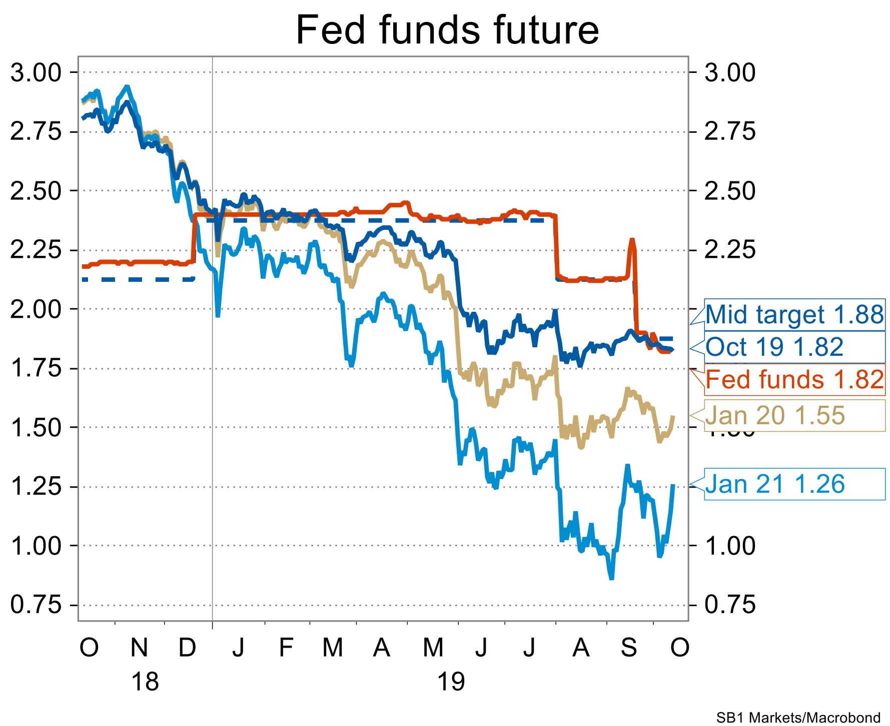
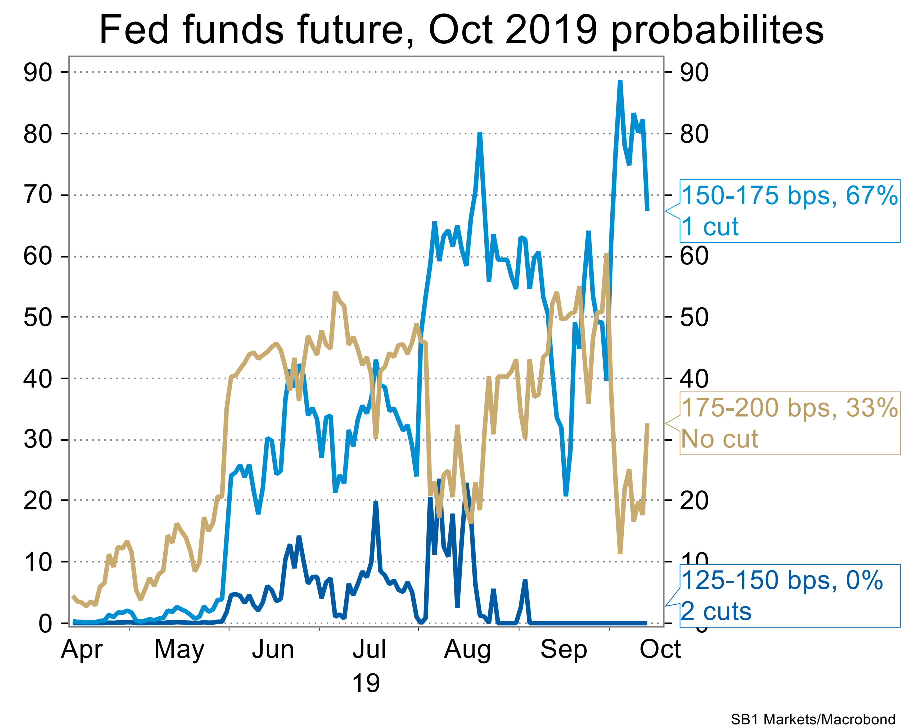
Fed fund futures edge up, still 67% probability of an October cut

Fed fund futures sharply up last week, removing almost one interest rate cut

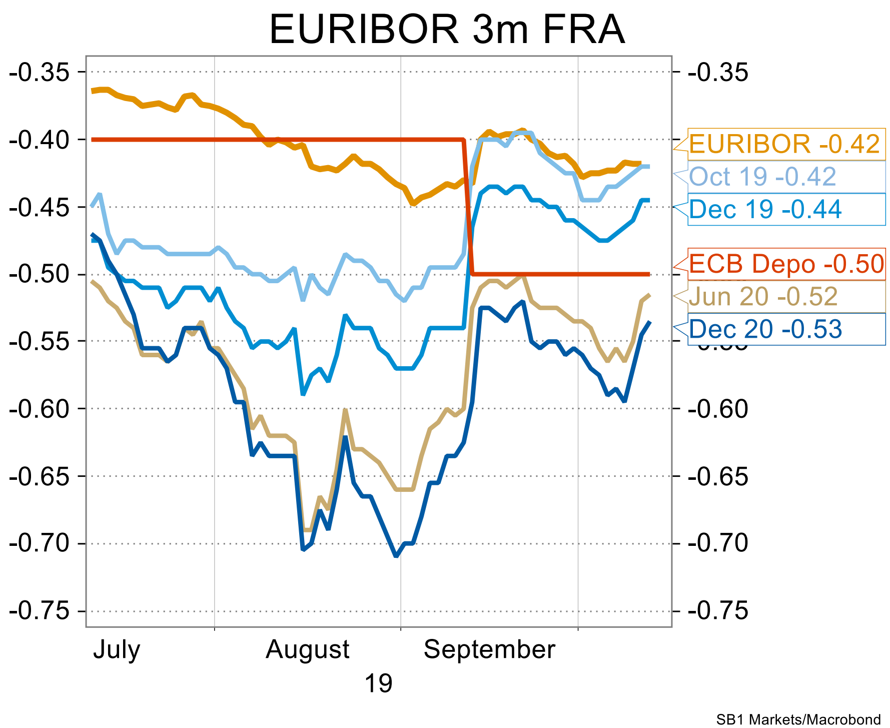


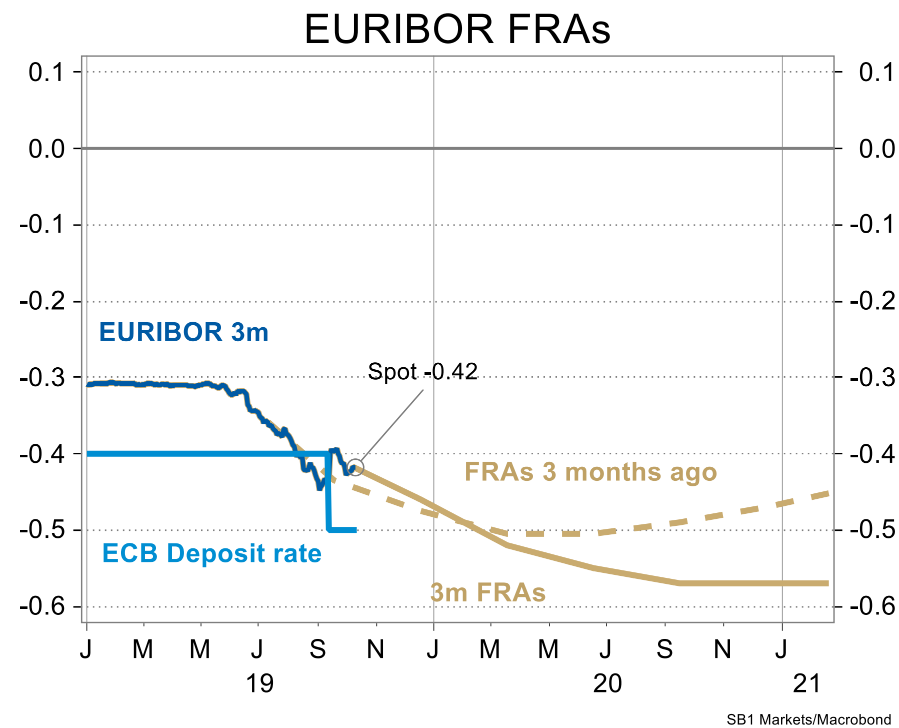


- The probability of a 25 bps Fed cut at the Oct 30 meeting is still elevated at some 67%, down from 90% late the prior week. The Jan '20 contract implies some 50% probability of another cut in December. 3 more cuts (of 25 bps) are expected by the end of '20, almost one cut was 'removed' last week, helped by hopes of a trade deal
- US growth is slowing but it is still above or at trend. PCE inflation is not far below the target. Yes, some 'soft' data are deteriorating but 'hard' data are not yet that weak. And the USD is stronger than normal but not by that much. <u>The economy does not justify another interest rate cut in October, in our view (and a few of the FOMC members')</u>

EUR FRAs are climbing too, some 30% expectations of another 2019 cut

FRAs are recovering all over the curve, fuelled by trade war optimism and ECB dissent

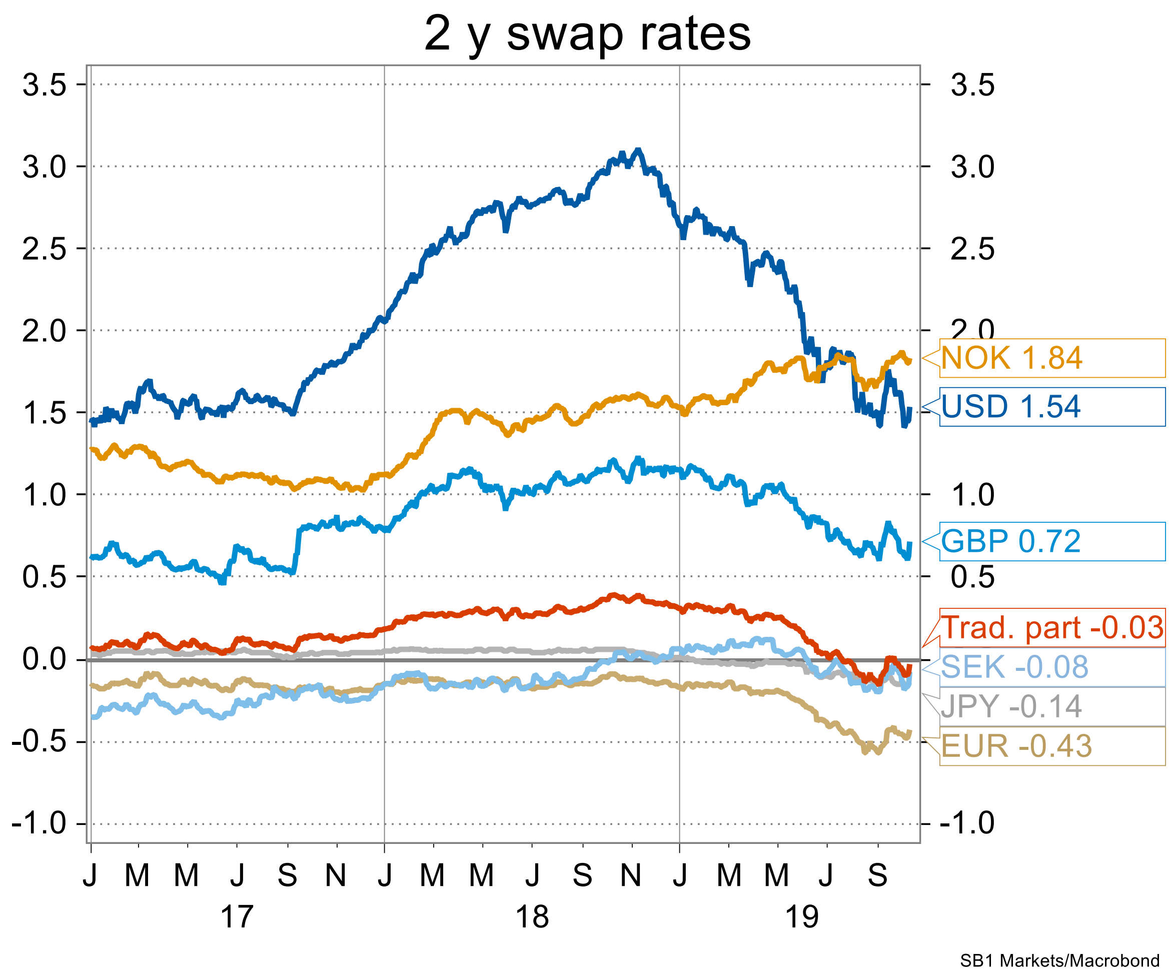


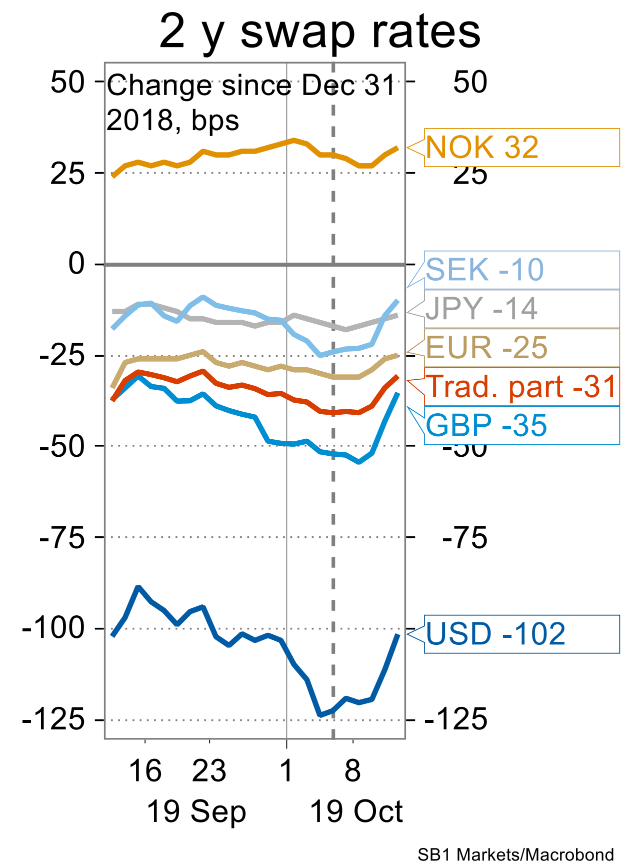


- Weak macro data sent EUR FRAs down in late Sept/early Oct. Last week, the FRA rates turned up all over the curve. Positive news as the US/China trade talks began turned the mood. Moreover, minutes from the ECB Sept meeting revealed opposition from 'several members' about the resumption of QE, making further monetary easing in the short term less likely. The Dec '19 contract implies some 30% probability of another interest rate cut this year
  - Not only were the ECB board members split on the reintroduction of QE, Minutes from the Sept meeting also revealed dissent on the assessment of the macro outlook and the decision on the two tier system. In addition FT reports that the ECB's monetary policy committee advised against the decision on bond purchases. Christine Lagarde will surely inherit a split ECB when she takes over on Nov 1.

Short term rates up everywhere, finally less in Norway than abroad

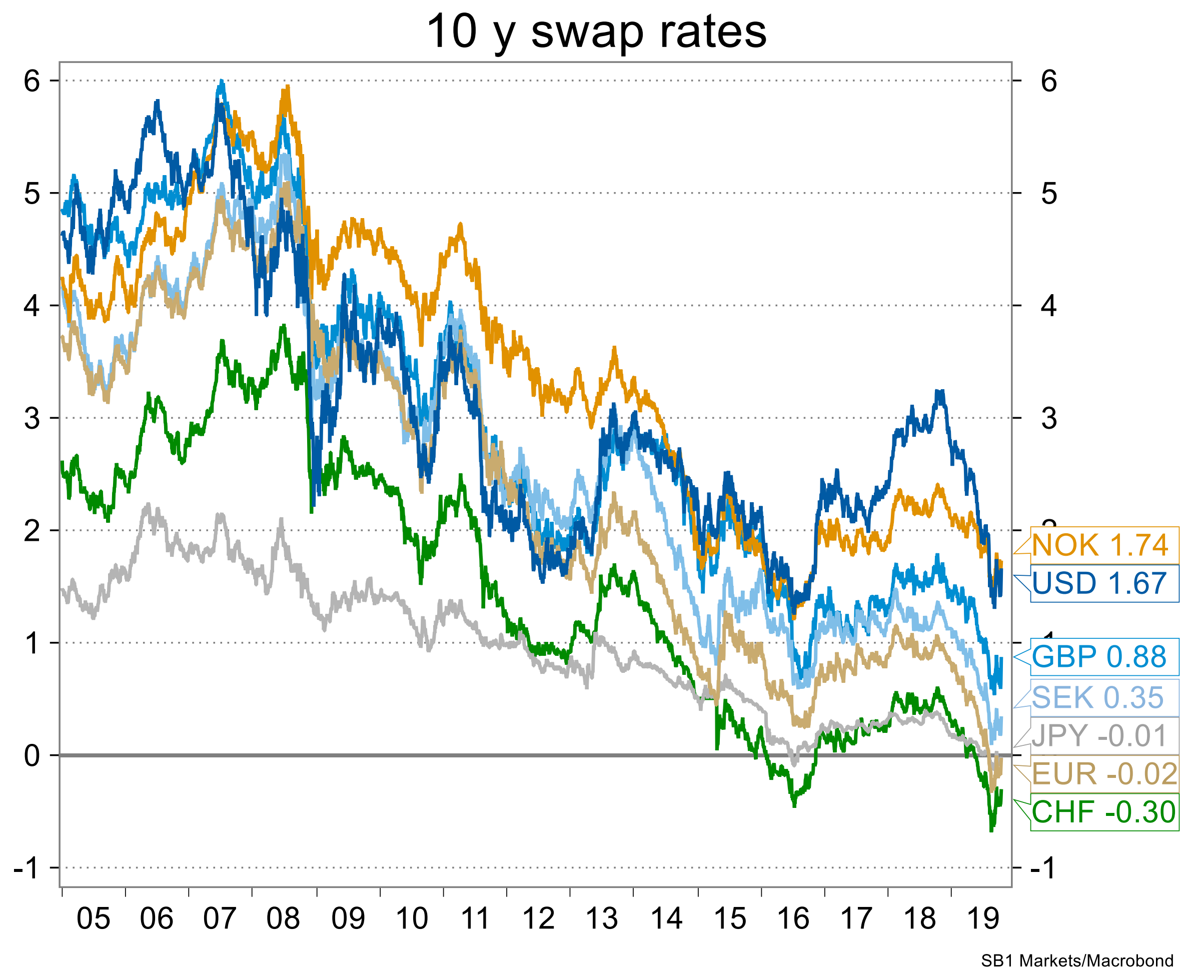
Short term rates edged up last week, GBP noted the strongest upturn, helped by Brexit deal hopes

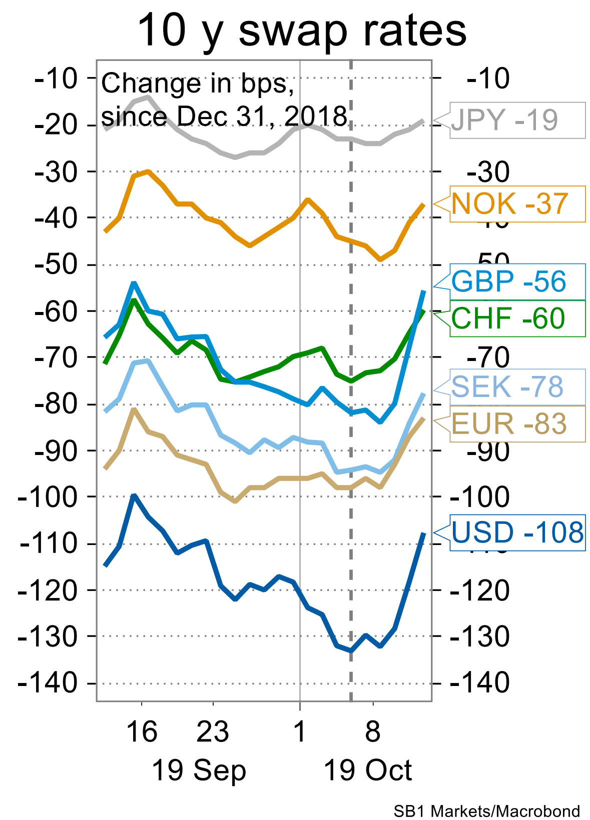




Long term swap rates up from the bottom

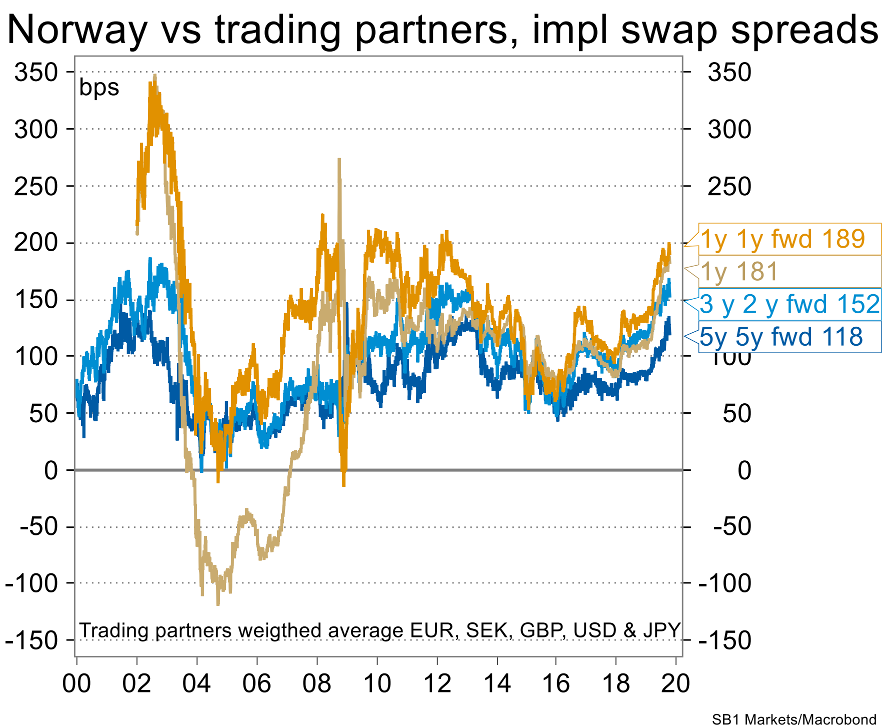
All swap rates have fallen steeply, US 10 y swap rate is 148 bps lower than one year ago

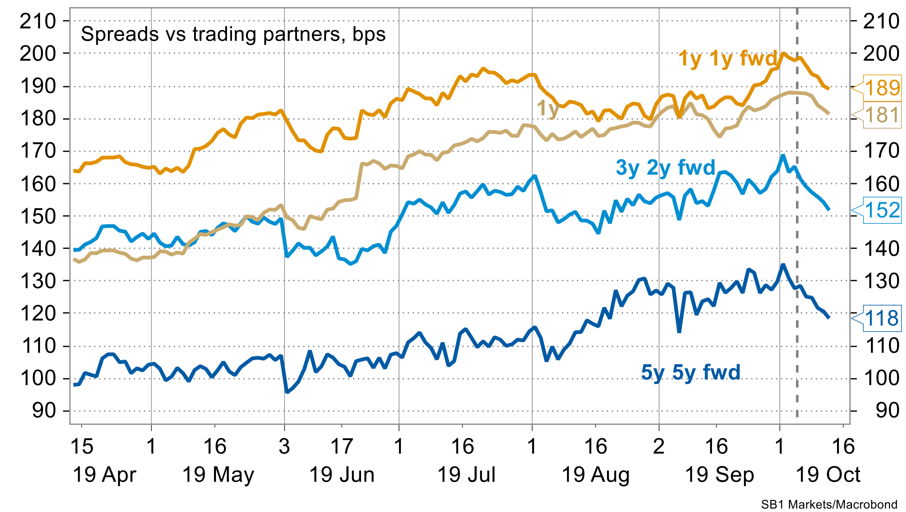


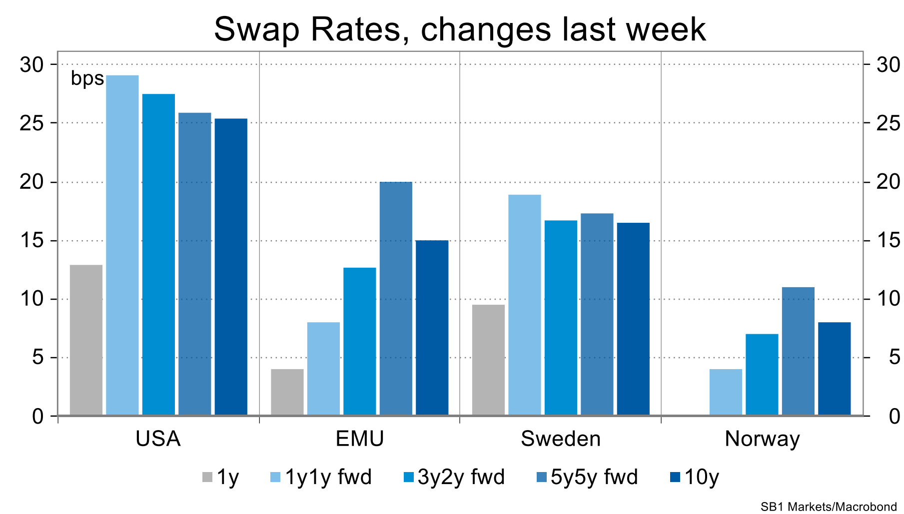


NOK swap spreads vs trading partners 'finally' caving in

Spreads fell among all maturities, as trading partners' interest rate rose more than NOK rates







- Swap spreads between NOK rates and our trading partners have been widening rapidly this year, all over the curve. Last week, spreads finally narrowed
- While the short term spread is well explained, we have been surprised by the wide spread in the long end of the curve of the since March. It must be 'too' high, still?

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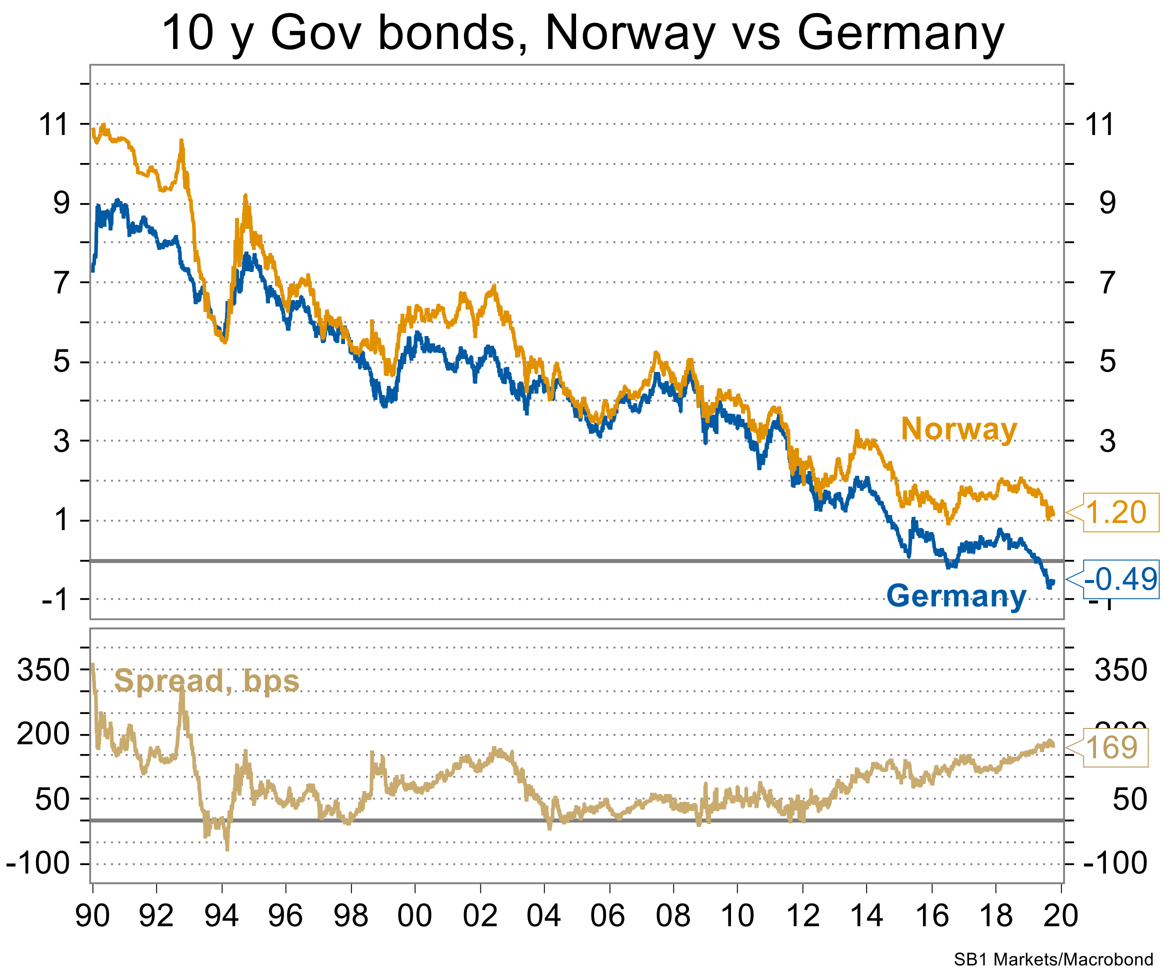
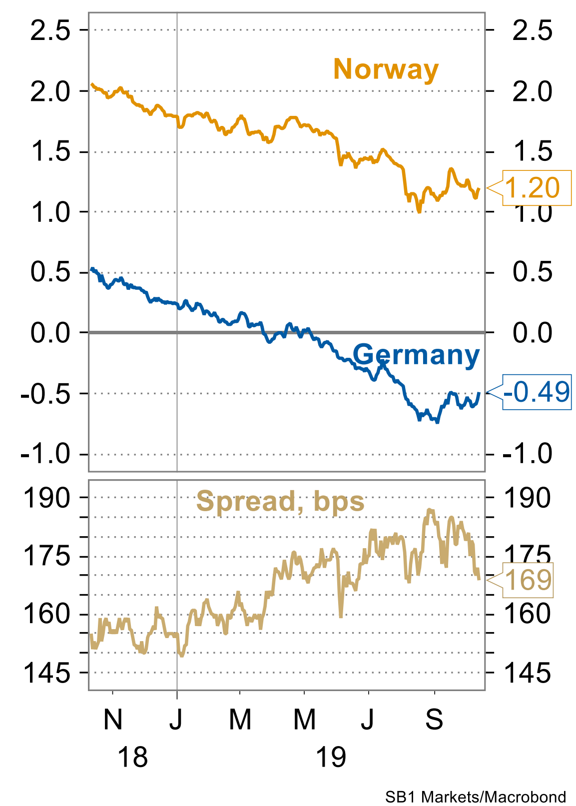
The Norway/German 10 y gov spread narrows somewhat

The spread at 1.69% is still unusually elevated (but it was 10 bps higher in late Sept)





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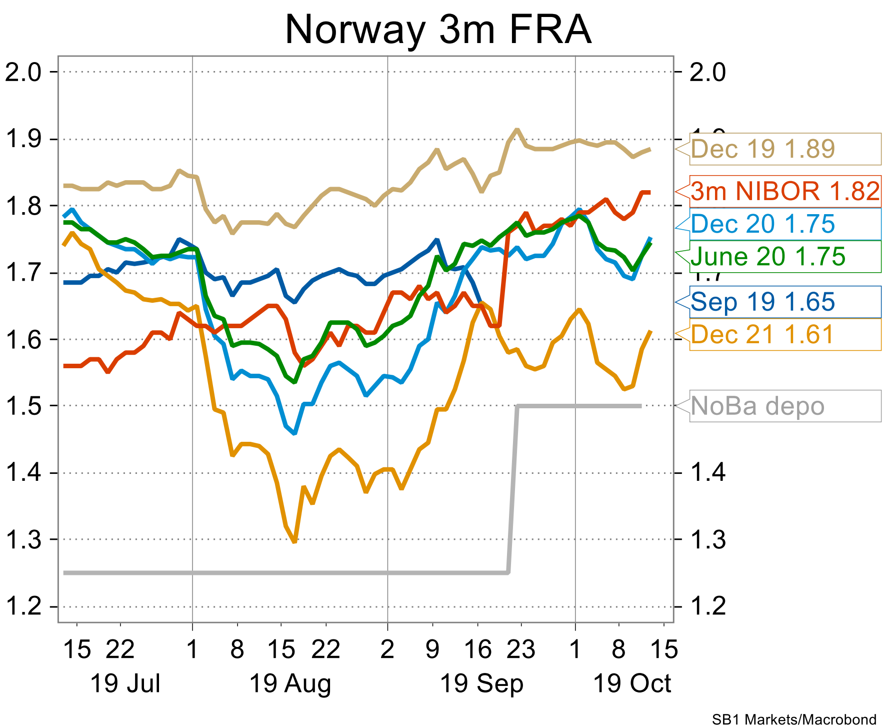
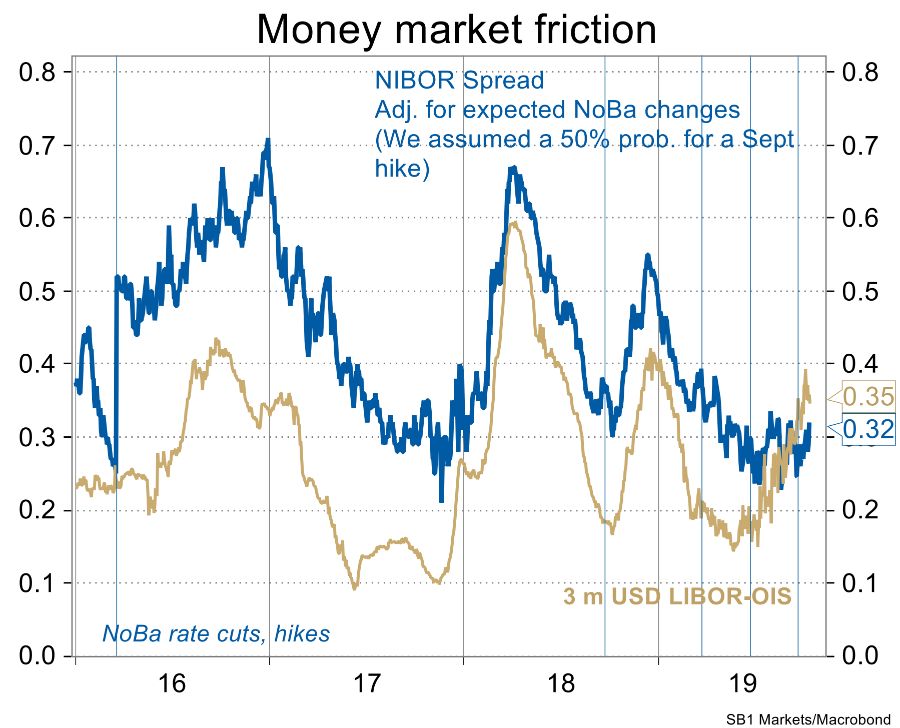
The 3 m NIBOR further up, to 1.82%. Still more to go?

Dec 20 contract at 1.89% still implies a higher spread (and zero hike probability, we assume)





- The NIBOR – NoBa deposit spread has come up to 32 bps, from 26 bp immediately after Norges Bank's hike on Sept 19. We still think the spread is too narrow. The Dec 3 m FRA trades at 1.88% (implying a 38 bps spread), and in the US the LIBOR-OIS spread fell to 35 bps last week, probably due the large liquidity supply from the Fed widened. Historically, the NIBOR spread has been wider than the LIBOR-OIS spread. Norges Bank assumed a 40 bps NIBOR spread in the MPR.
  - » The Dec spread may be influenced by expectations of a year end liquidity squeeze – which has happened before. The FRA-curve peaks in Dec '19, and there are smaller local peaks in the next Dec FRAs as well. Still, we expect the 3m NIBOR to drift further upwards the coming weeks
- Longer dated FRAs edged up last week too. The FRA curve is inverted after Dec '19, the market is pricing more than a 50% probabily for at cut from Q1-2 in 2021 (assuming 35 bps spread), and a 'full' cut by Q4 2021

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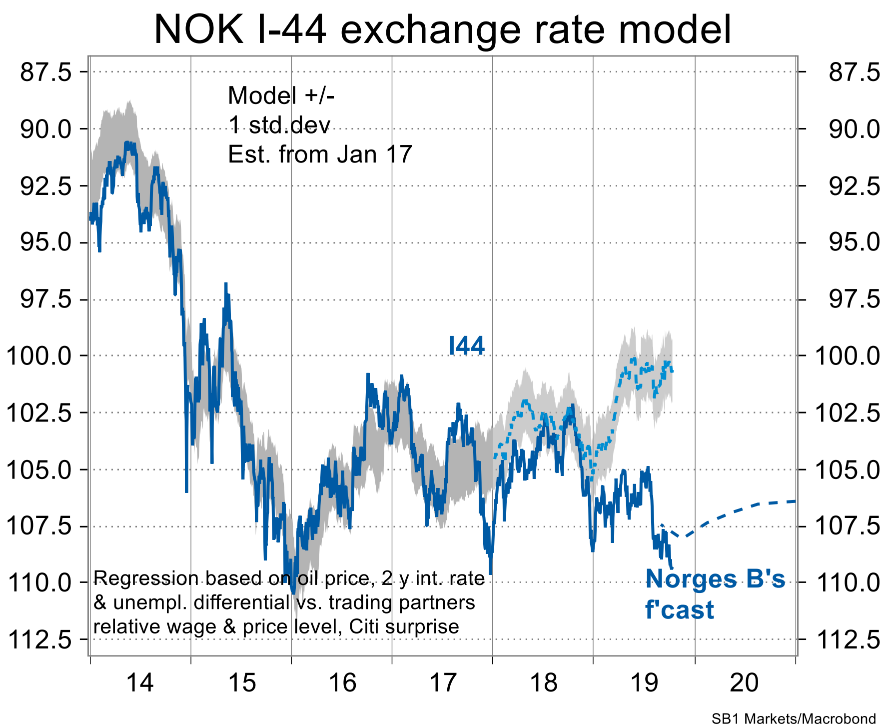
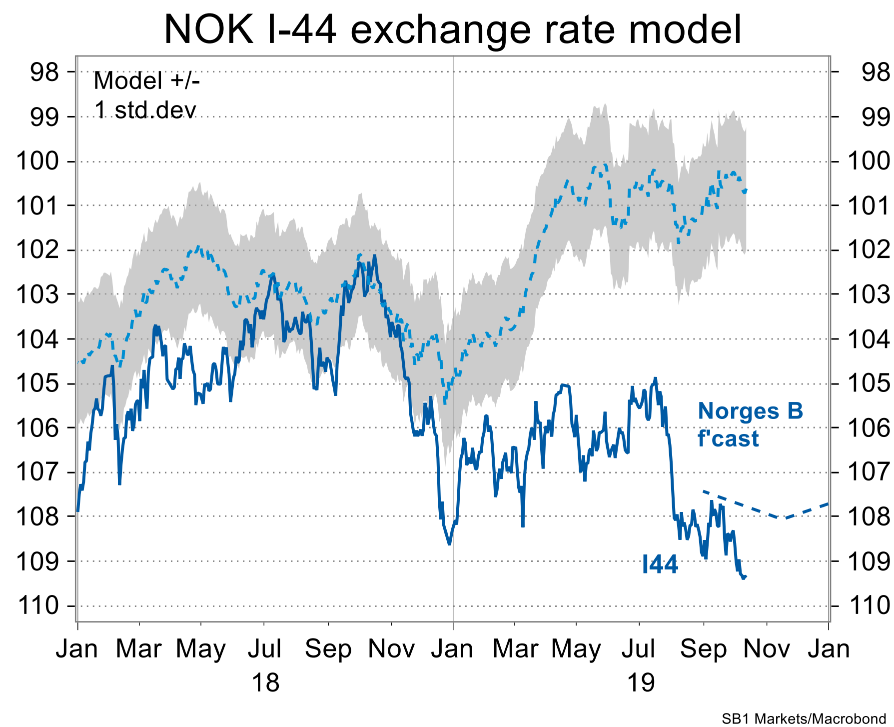
NOK down again last week, while the oil price and our ‘peers’ stabilized

NOK is 8.8% below the standard model and even 4% below other supercycles

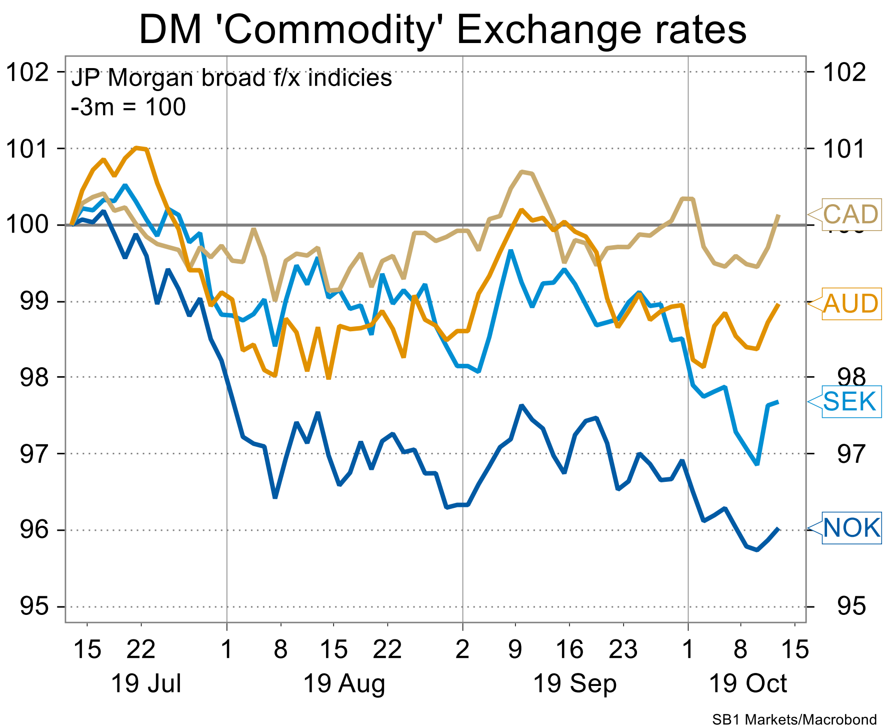


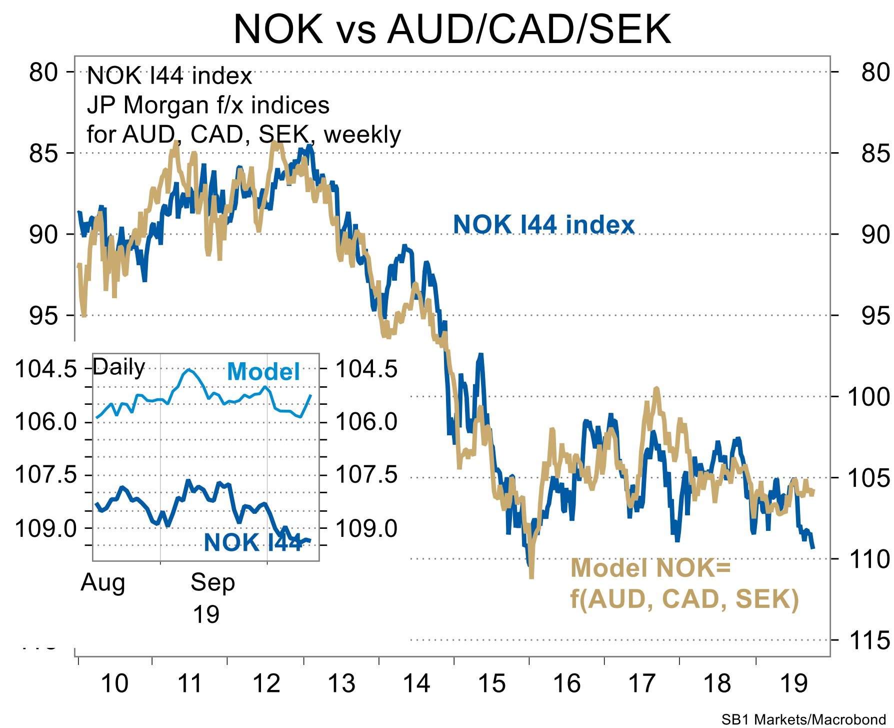


- NOK depreciated slightly last week, together with the model (0.2 – 0.3%), pulled down by lower interest rate spreads. The gap to the model is wide, close to 9%, the highest we have witnessed
- Last week, the other ‘supercycle’ currencies recovered somewhat. NOK is some 3.5% below our super cycle peers. Global risk sentiment, concerns on housing/debt may explain the dip in supercycle currencies but not the specific NOK weakness since July
  - » We have tested our models with global risk etc., without success. Some argue that the NOK weakness is due to investors’ lack of confidence in the petroleum sector, however, the relative performance of global/Norwegian oil stocks fails to explain the NOK depreciation since the summer. What about the volume of NOK transactions? Well, we lack adequate data but we have not seen any reports on liquidity problems
- Long term, our main assessment is that the NOK will strengthen and we stick to our **buy NOK** recommendation

Other ‘supercyclicals’ stabilized last week, the ‘gap’ to NOK rose to 3.5%

CAD is much stronger than the others, AUD & SEK have fallen less than the NOK since July





- Both CAD, AUD and SEK recovered more than the NOK late last week, SEK was helped by slightly higher inflation than exp.
- Together, the other supercyclicals cannot ‘explain’ the recent NOK setback. The NOK has almost 4% vs. the supercycle f/x model estimate since mid July. The discrepancy is not unusual but not something that happens that often either
  - » Our model is tilted towards the link between NOK and CAD, more than towards AUD or SEK (even if AUD works pretty good). Since July, the CAD has been rather stable, while AUD & SEK have depreciated but both less than the NOK

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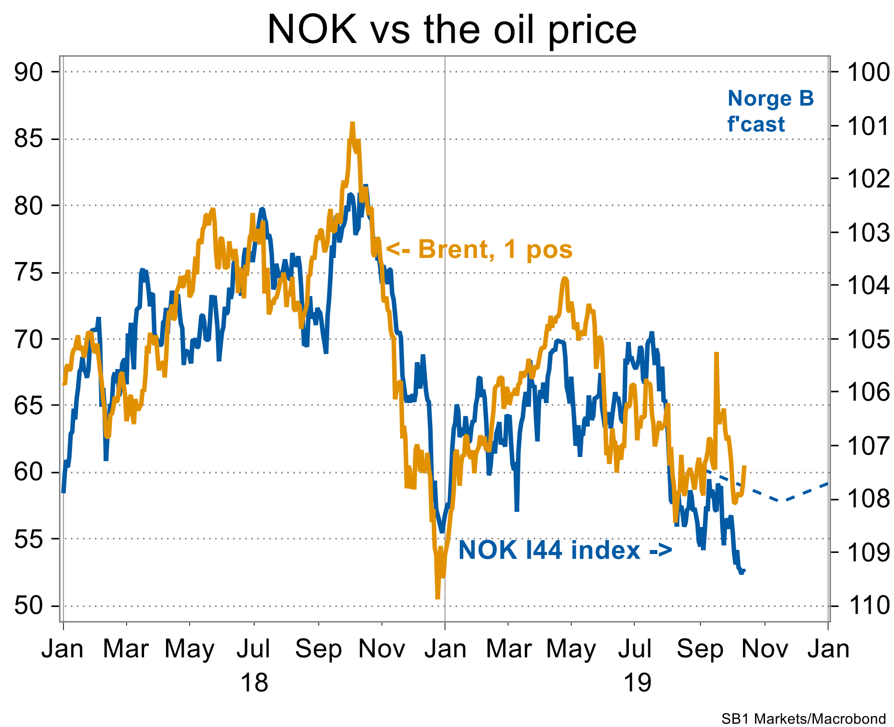
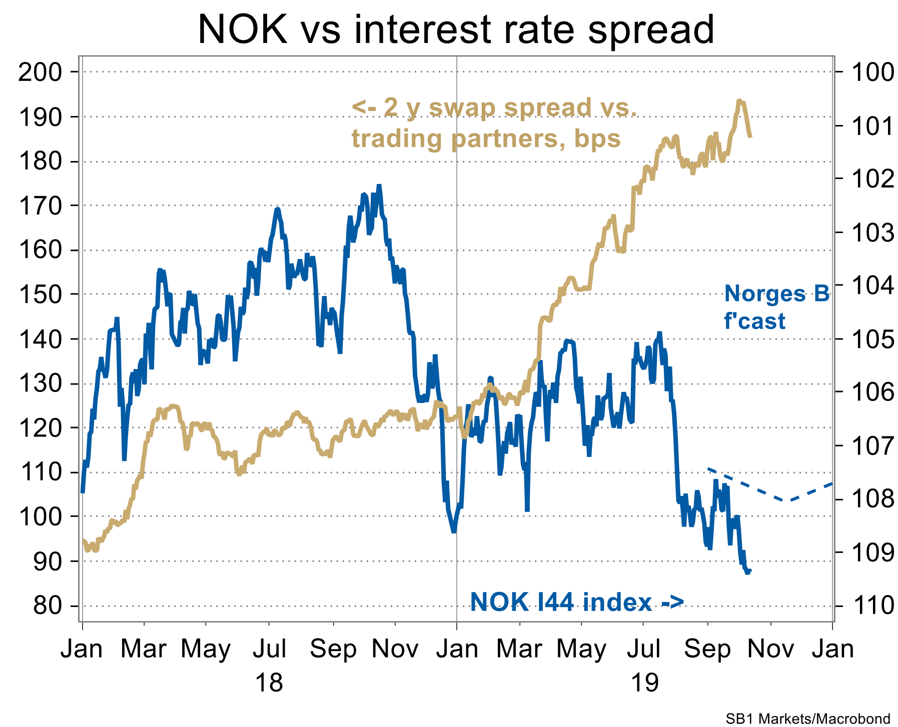
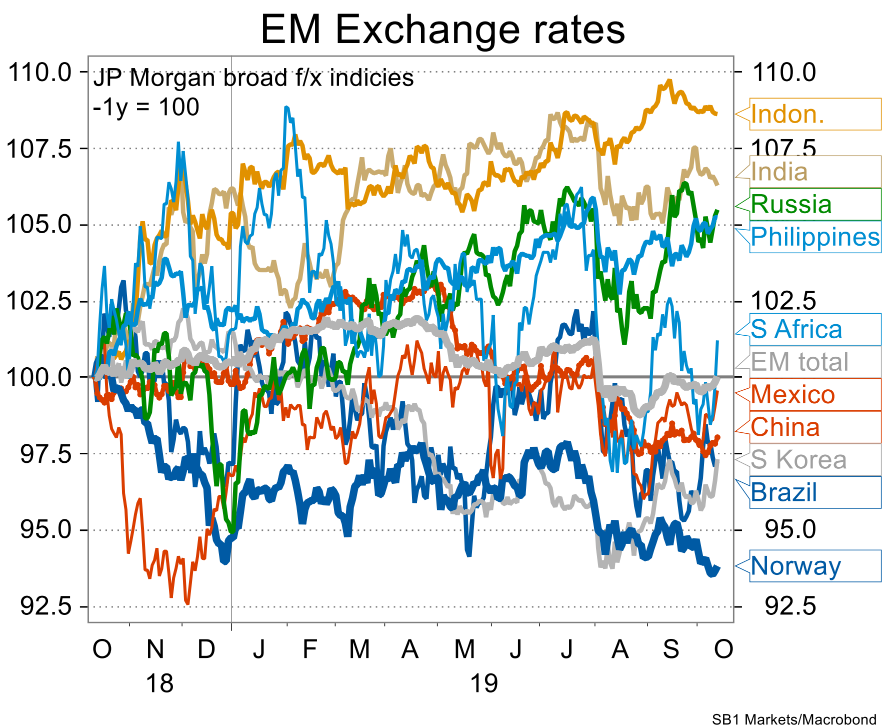
Oil price slightly up, the 2y interest rate spread vs. trading partners down

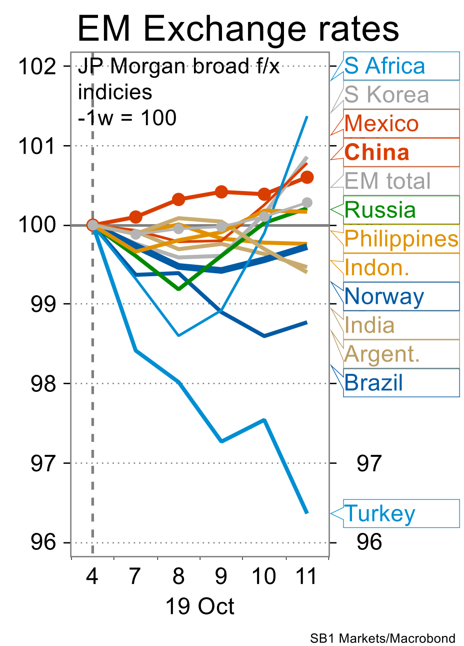


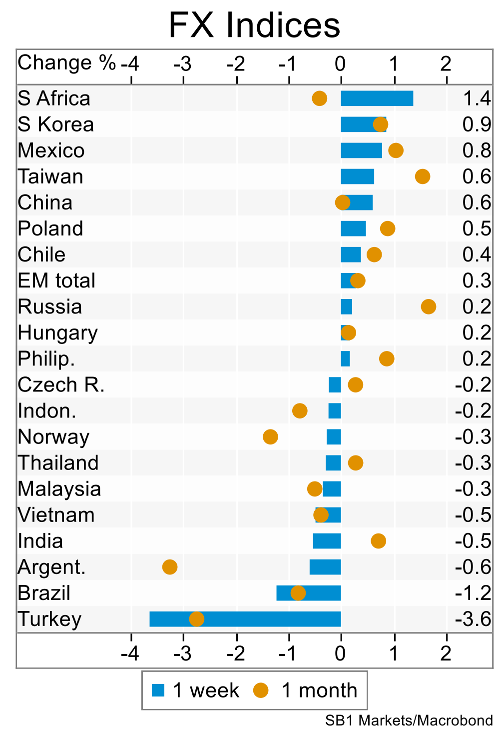


EM f/x in up, with the CNY. Is someone kidding with Turkey??

Most EM currencies have appreciated the past month. Turkish lira suffered after the attacks in Syria







- Most EM currencies have stabilized/recovered in Sept/Oct, and trade sensitive currencies rose last week. Trade war de-escalation probably the best explanation
- BTW, if we take out the Argentinian peso, the NOK has fallen substantially more than any of the (other) 18 main EM currencies we are following the past year!

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